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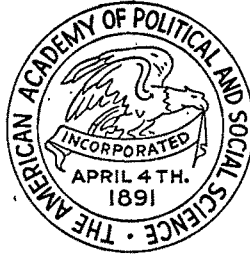
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INFLATION

Special Editor of this Volume

• ALFRED G. BUEHLER, Ph.D.

Professor of Public Finance

University of Pennsylvania

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The Problem of Inflation

By ALFRED G. BUEHLER

ABSTRACT: Many persons have recently expressed great concern over the problem of inflation. The President has warned repeatedly against its dangers and a Cabinet Committee has reported that action is needed to forestall inflation and assure sustained economic growth and social progress. Inflation involves rising consumer prices under conditions of so-called "full employment." Many explanations of inflation have been offered, but whatever the cause, the consumer bears the brunt of it, and it unequally affects the population. The price level flattened out during the 1957-58 recession and has recently shown signs of advancing toward new peaks. Some persons regard inflation as no real threat in peace time and may even think it is a necessary price of continuing economic growth. It is more difficult to arouse the population to the evils of inflation than it is to the dangers of recession and depression. To halt inflation it is necessary to curb excessive spending by governments, businesses, and consumers until the supply of desired goods and services has become adequate. It may also be necessary to increase taxes and apply other controls which are unwelcome. Reasonable stability of prices must be accepted as a national goal along with reasonable economic growth and social progress.

Alfred G. Buehler, Ph.D., L.H.D., Philadelphia, Pa., is Professor of Public Finance at the University of Pennsylvania. He is the author of various books and articles on public finance and has served as President of the National Tax Association and President of the Tax Institute, Inc.

THE newspapers recently reported that the cost of living index pushed upward to a record high level. They have been replete with comments about postwar inflation and the possibilities of further price increases. Some observers think that creeping inflation is a real long-run danger.

President Eisenhower has warned repeatedly against the menace of inflation. His former economic adviser, Professor Arthur F. Burns, is so concerned over the dangers of creeping inflation that he has written a book, *Prosperity Without Inflation*, in which he diagnoses the causes of inflation and the measures he believes may be needed to curb it.

Last January the President appointed a special Cabinet Committee on Price Stability for Economic Growth, headed by Vice President Nixon. He also named Dean Allen Wallis of the School of Business of the University of Chicago Executive Vice Chairman. At the end of June 1959 the Committee released its first interim report. The Committee, consisting of five Cabinet members entrusted with economic and financial responsibilities and Dr. Raymond J. Saulnier, Chairman of the President's Economic Council, expressed its unanimous opinion "that our economy is now at a critical juncture urgently requiring action to forestall inflation and insure sound and sustained economic growth and progress." (The report is attached in the appendix.)

The issue of inflation is also the subject of Congressional inquiries and debates. It enters into controversies over appropriations, taxation, the public debt, the activities of the Treasury and the Federal Reserve System, the profits of big business, and the wage demands of labor unions. It is evident that inflation is a complex financial, economic, political, and psychological problem and that there is much disagreement over

the prospects of continuing inflation, its causes and dangers, and what, if anything, should be done about it.

WHAT IS INFLATION?

To many persons inflation implies an insidious, cancerous swelling of prices and the erosion of the purchasing power of their incomes and savings. It has frequently been called the cruelest of all taxes, hitting everyone and especially those with small and fixed incomes. Life insurance companies, many banks, and many corporations have recently been emphasizing the evils of inflation and the need to stop it.

Other persons, with incomes increasing faster than prices and finding advantages in inflationary booms, may look upon inflation as a blessing. Some argue that in recent years prices have stabilized and that inflation is an illusion. Still others contend that economic growth and social progress require some increase in the level of prices.

To the individual, inflation is a money problem. He relates it to the high cost of living. He may see the remedy in acquiring more dollars, even if their purchasing power falls. He may fail to realize that purchasing power must ultimately be limited by the production and supply of goods and services and the demand for them. His remedy for inflation, increasing the availability of money by one method or another, may cheapen his money by forcing prices upward.

Economists have related inflation, with its rise in the cost of living, to periods of full employment of labor and other resources. It is thus a phenomenon of booms and prosperity.

Complete agreement has not been attained, unfortunately, on the definition of full employment. There is always some unemployment of labor, machinery, buildings, and other productive facilities. The modern economy is never

completely stable. We all want growth, even if its costs are some instability and unemployment. Arthur F. Burns finds that economists have recently assumed that the minimum unemployment is something like 4 per cent of the labor force.¹ This does not, of course, delimit what might be regarded as the minimum amount of idle plant and equipment. Actually, our measures of full employment are quite crude and occasion much controversy.

Inflation has been associated with sustained, substantial and even wild increases in prices during and after wars. The American Revolution, the Civil War, World Wars I and II, the Korean Conflict, and the ensuing cold war have been attended by rising prices. Wars are commonly financed largely by borrowing. Currencies depreciate and prices soar. After a costly war, there may be a great outburst of inflation and rising prices.

In certain periods in modern history, a great influx of gold has brought rising commodity prices. Both gold and silver have been found to be unstable bases for the monetary system. Paper money, bank notes, and various forms of credit may be issued in such amounts during wars, postwar booms, and times of speculative fervor that currency depreciates in value.

Inflation may be temporary, as during the boom period of a business cycle, or it may run over a period of years. If the creeping inflation gives way to wild uncontrolled inflation, the monetary system may collapse, government and other debts may be repudiated, and public and private insolvency may result. One may find many examples in modern history of runaway inflation.

Inflation has long been thought of as a condition resulting from a super-

abundance of currency in relation to the available supply of goods and services. With a strong demand, a limited supply of goods and services, and a great inflow of purchasing power in the markets, the pressures on prices increase and tend to force them upward. Too many dollars are said to be chasing too few goods. The so-called "demand-pull" factors compel prices to rise.

As many newspaper writers have stated, recently there has been much emphasis on the so-called "cost-push" factors in the attempt to explain how inflation occurs. Prices are said to be rising because costs are climbing. Big business may be blamed for high profits and administered prices. Labor unions may be blamed for compelling employers to yield wage increases exceeding gains in productivity. Higher interest rates, taxes, and other costs may also be cited as "cost-push" factors.

Disputes over the importance of the "cost-push" factors may divert attention away from issues other than inflation. The appropriate rewards for labor, the taking of risks, managerial service, and other economic activities are questions involving more than the issue of inflation. There is always a struggle between employers and employees over "the cutting of the cake," that is, the distribution of the output or income of an undertaking. How much of the income of an enterprise should go out in profits, interest, wages, and various other shares is a continuing and inevitable problem. In the controversy over wages and profits, the question of inflation may be dragged in as each side seeks to place blame on the other for price increases and both seek to obtain the largest possible share of the income of the undertaking.

Increases in wages and profits may be a symptom of inflation rather than a cause of it. At any rate, in the opinion of many economists, monetary and "de-

¹ *Prosperity Without Inflation* (Buffalo, N. Y.: Smith, Keynes and Marshall, 1958), p. 29.

mand-pull" factors are very largely responsible for recent price increases. If increases in wages and profits are inflationary, it may be much more difficult to prevent them than it is to control the monetary factors involved. Wage, rent, and other price controls have commonly been rather futile in the face of strong inflationary pressures.

THE MEASUREMENT OF INFLATION

It is commonly agreed that inflation involves an increase in the cost of living, particularly in periods of high employment and prosperity. Over the measurement of inflation, as well as the causes, implications, and remedies, there has been much controversy. Changes in the cost of living and the purchasing power of money are measured by indexes of relevant data. The construction of price indexes involves many technical and practical problems. The indexes refer to conditions assumed to be more or less typical of the situations covered at a given time. Cost of living indexes may thus refer primarily to the living costs of families of wage earners and clerical workers in our cities.

The consuming and expenditure habits of families are not completely uniform at one time or over periods of time. The commodities and services purchased may vary from time to time and place to place. The breads, pastries, and other foods of today are not altogether identical with similar commodities ten or twenty years ago. Clothing, shelter, home furnishings, and other commodities and services do not remain entirely uniform.

With the changing modes of living, size of families, age of population, and other factors, demand changes in the markets. More income means more leisure and travel, as well as other changes in levels of living.

Price and cost of living indexes, therefore, suffer various limitations, even

after corrections for changing conditions of demand and supply. Some observers argue that the quality of many goods and services has improved to a greater extent than the prices. Thus, it is said that while an automobile may cost much more today than a decade ago, it is a superior vehicle. Others, to be sure, may deny this and argue in the opposite direction. The question is, how can price changes be related to changes in quality and quantity of goods and services purchased?

Another factor involved in the construction of price and cost of living indexes is the allowance for the cost of government as revealed in taxes and other charges. The taxes which constitute business expenses and are reflected in prices are included in prices and living costs. As government services increase in quantity, tax rates may be increased and new taxes may be imposed. If the quality of government services is raised, taxes will also tend to rise. But higher taxes and other charges may result from greater population density, as in urban and suburban areas, rather than from more and better service. It is well known, for example, that the per capita costs of local government tend to increase as population increases, not only because new and better services may be demanded but also because of the greater difficulties encountered in serving concentrated populations and increased unit cost pressures.

Taxes reflect inflation as governments find it necessary to pay more for the goods and services they purchase as prices advance. Higher salaries for government employees may not mean a higher quality of service. In public, as in private, employment, productivity may not increase so fast as wages and salaries.

Another complication arises in making allowances for taxes. Farm sub-

sidies and other payments to various industries may conceal the cost to the consumer and taxpayer. Farm prices may be reduced or held down, but personal income and other taxes supporting the subsidies are higher because of the subsidies. But taxes not included in prices will be excluded from the cost of living index.

Generally speaking, there is lacking a cost accounting system which could measure the costs of government in terms of uniform service units. Both the quality and quantity of public services are subject to variation.

Still another complication arises. The services provided by governments, as in public education, health, and welfare, may be paid for largely with income, property, and other taxes imposed on persons who receive little or no direct benefits. The value of the benefits received may be far greater than the cost to those who receive the services. The taxes paid, then, do not show the services enjoyed.

The measurement of living costs, in conclusion, is a rather crude technique which measures some changes in purchasing power and conceals other changes. Lacking more adequate statistics of living costs, however, use is commonly made of price and cost of living indexes for what they may be worth. With their limitations in mind, there are presented here two charts which were designed to indicate certain price changes.

IS INFLATION A MENACE?

If one may judge by the recent outpouring of books, articles, government reports, and other literature on inflation, there are many persons who regard creeping inflation as at least a potential menace. There remains the question, of course, of whether we are able to contain inflation if it does threaten our

financial and economic stability and our social progress.

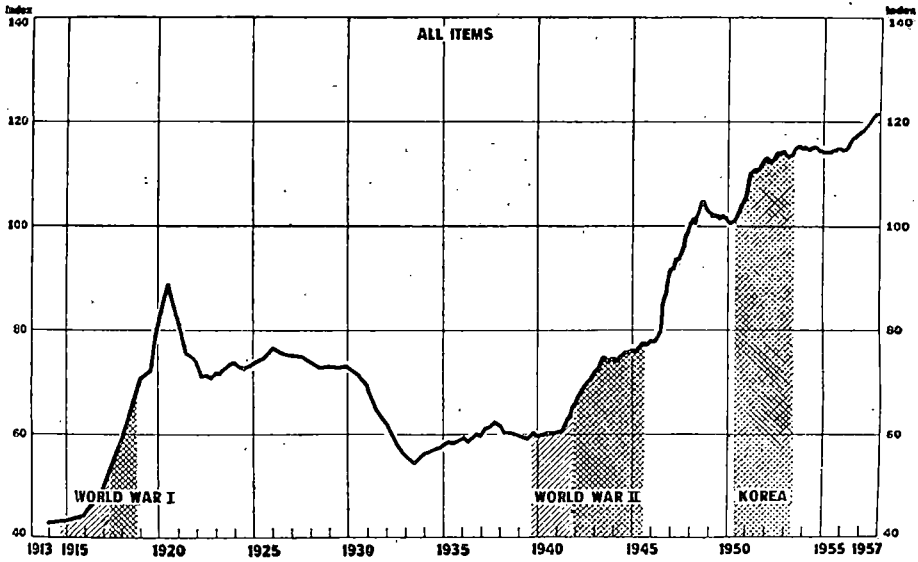
One may note the rise in the consumer price level by observing that consumer prices, as reported by the United States Bureau of Labor Statistics, have risen from 42.3 per cent of the 1947-49 average in 1913 to 124.5 per cent in June 1959. The index averaged 59.4 per cent in 1939. It climbed to 114.8 per cent in 1954, fell slightly in 1955, and averaged 123.5 per cent in 1958.

The index rose to a peak of 35.7 per cent in 1920, then declined to a low of 55.3 per cent in 1933. During and after World War II, the consumer price index rose rapidly and climbed to a peak of 102.8 per cent in 1948. After a small drop in 1955, the index again moved upward to 123.9 per cent in July 1958, wavered through March 1959 with slight variations, and went back to 123.9 per cent in April 1959. After watching the rise in consumer prices through May and June 1959, the Cabinet Committee on Price Stability for Economic Growth expressed fears that the boom in business and the renewed increase in the cost of living portend a serious inflation menace unless corrective measures are taken to forestall the threat.

The Conference on Economic Progress, of which Leon H. Keyserling, the economic adviser to former President Truman, is President, has criticized the attack by the present Administration and private organizations as a spurious crusade against inflation.² It is argued that the campaign against inflation overlooks the fact that most inflation has been due to war, that much less inflation has occurred than claimed, that the talk about inflation has aggravated the danger of inflation, that economic growth would be sacrificed to price sta-

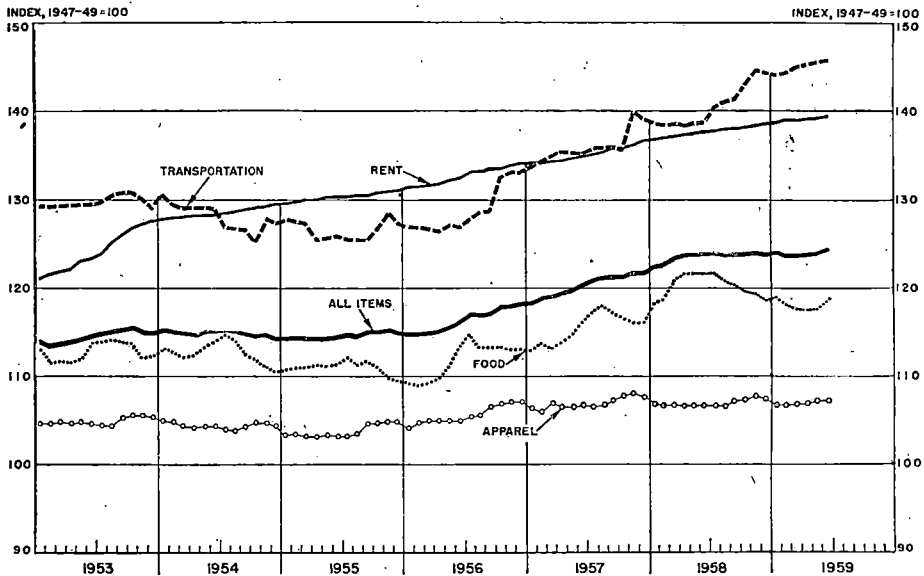
² See Conference on Economic Progress, *Inflation—Cause and Cure* (Washington, D. C.: Conference on Economic Progress, 1959).

CHART 1—CONSUMER PRICE INDEX: 1913-1957



Source: *Statistical Abstract*, 1957, p. 327.

CHART 2—CONSUMER PRICE INDEX: 1953-1959



SOURCE: DEPARTMENT OF LABOR.

COUNCIL OF ECONOMIC ADVISERS

Source: *Economic Indicators*, July 1959, p. 23.

bility, and that economic and social growth can be accomplished within a framework of reasonably stable prices.

The Great Depression of the 1930's gave birth to the "New Economics" which contended that capitalism was addicted to chronic unemployment and depressions. At the close of World War II and since, there has been a fear among some economists that our economy would slump into another great depression despite some temporary inflation. To prevent mass unemployment and general depression and to assure continued economic growth at a satisfactory rate, it is said that the spending by consumers, business, and government must be increased. Some economists, indeed, regard mild continued inflation as an inevitable price of sustained growth. Government deficits thus become normal. Wage and other income increases are found necessary to provide increasing consumer spending.

That there is some inconsistency between the goals of growth and stability cannot be denied. A completely stable economy would be a static one. A dynamic, growing economy, which most Americans desire, will always experience some imbalances, some unemployment of resources, and some local depressions. General downward movements as well as general prosperity, with the risk of at least temporary inflation, are inescapable in our complex economy. Reasonable growth with reasonable stability are the most that we can anticipate.

We have not yet learned how to iron out the general fluctuations in the economy which we call business cycles. The patterns of the succeeding cycles vary somewhat and defy complete understanding. Short periods of inflation during business booms, each bringing a higher price plateau, would seem to be possible. Particularly possible is this type of creeping inflation if prices do

not fall during a recession. Thus, in 1959, the price level in recovery is already high because the recession of 1957-58 failed to produce a general price decline.

State and local government taxes are increasing as their rates advance and as new taxes are added. Federal taxes remain high, with little prospect of reduction. The expenditures of all levels of government have been increasing at a faster rate than tax collections. Government debts, as a result of extensive borrowing, have been increasing. Even in times of prosperity there is great inertia and resistance to increasing taxes and service charges sufficiently to prevent inflationary government spending.

Another costly war would shoot federal spending and the debt skyward. It would also bring tremendous inflationary pressures.

Aside from war, however, there are forces at work which could combine to generate continuing inflation, except in short periods of recession. Consumer and business, as well as government, spending is high and increasing in our growing economy. Much of the increase is financed by borrowing. When the money, including currency, in the markets is increasing at a faster rate than the supply of goods and services, the pull of demand will compel prices to rise.

Many persons anticipate continuing inflation and borrow and buy accordingly. Escalator clauses are inserted in some wage contracts to assure that the purchasing power of wages will be maintained. Wage increases are demanded as an offset to inflation with the argument that workers are producing more and are not sharing equitably in business earnings. Inflation invites rising prices, and higher prices invite higher wage, interest, and other costs. Whether the higher costs and prices are the re-

sult or cause of inflation, the consumer is the victim of the price squeeze.

The anticipation of inflation has obviously affected investment and speculative activity. Hedges against inflation are being sought in common stocks, real estate, and various commodities. Fears and hopes of speculative gains feed on inflation and breed further inflation.

To recite the facts of history and remind ourselves of the waves of inflation during and after wars and in some boom and speculative periods and the mild inflation running into 1957 does not prove, of course, that inflation is a serious long-range threat. The rise of inflation in the past and the instability of our economy at present do, however, point to the possibilities of at least mild inflation in the future. It is evident, too, that mild inflation may become wild inflation if the necessary fiscal, monetary, and other restraints are not judiciously applied.

THE INDIFFERENCE TO INFLATION

Granted that there are risks of inflation in the modern dynamic economy, is inflation a real or an imaginary menace? Modern nations have recently shown much more concern over the problems of recession and depression than over prosperity and inflation. When the economy is in a slump, there are cries for massive measures to end it by stepping up government spending, reducing taxes, lowering interest rates, encouraging borrowing by other measures, providing subsidies to consumers and business enterprises, and otherwise increasing the flow of money in the markets to stimulate total spending. Just a little increase in unemployment and the existence of local depressions are enough to create a clamor for "the government to do something."

Mild inflation has pleasantly intoxicating effects on many persons. If the

masses have more money, they are carried away by the money illusion and think they are better off until they wake up to the fact that prices have increased as much as, or more than, their incomes. Those who experience a gain in purchasing power want the good times to continue. They dislike paying higher prices which bring more dollars to other persons, but if their supply of dollars increases at a rate sufficient to give them more purchasing power, they are prone to think that inflation has really been a blessing to them. The losses in purchasing power suffered by those with fixed or slowly increasing incomes are not counted, nor is the danger that the instability of inflation will eventually give way to deflation and widespread unemployment considered to be imminent or serious.

To halt inflation, it is necessary to curb excessive spending by governments, businesses, and consumers until the supply of desired goods and services has become adequate and perhaps to increase taxes and apply other controls which are unwelcome. If interest rates are raised by the Federal Reserve Banks to help check inflationary borrowing, it will be argued that higher interest rates raise costs and are inflationary. Buyers and sellers whose activities are slowed down or halted will cry out in anguish against the anti-inflationary measures, and those in political offices will hear their cries.

It is plain that a little inflation is a popular tonic. What it may do eventually to the individual and the nation's economy as its doses are continued may be so remote as to seem not worth calculating. There may, indeed, be a conviction that economic and social growth requires continuing doses of inflation and that modern man is fully competent to control the dosage of and the reactions to this powerful drug.

Those who are greatly concerned

about inflation today generally do not anticipate swift runaway inflation of the type that may burst out during and immediately after wars. They do fear the threat of mild continuing inflation. Like termites eating away steadily at the foundations of our homes, this type of inflation, if not halted, may, in time, cause the price level to rise materially. Its ultimate effect on prices and purchasing power could be somewhat similar to the swifter and more spectacular effects of runaway inflation.

WHAT MAY BE DONE ABOUT INFLATION?

Assuming that inflation has been at work during the 1940's and 1950's and that it may be a threat in years ahead, what should be done to curb it when it endangers the healthy flow of economic activity? The question involves many complications and will be the subject of discussion in the ensuing papers in this issue of *THE ANNALS*. Greatly oversimplified, the approach to the prevention and curbing of inflation requires effective action along several lines.

Economic analysis and economic forecasting must be improved and rationally employed. No one can fully foresee the future. Economic forecasting has frequently been in error in the past and some of those who have been eager to combat depression or prosperity inflation have been willing to utilize massive doses of control prescriptions without fully calculating the consequences or have been too fast or too slow in their application of control measures. Some would go to the extreme of introducing rigid government controls over virtually the whole economy. Others would go to the opposite extreme and rely exclusively, or practically so, on private action. Over the economic effects of government and private activity there is much uncertainty and controversy.

Needed is the continuous appraisal of the effectiveness of financial, monetary, and economic measures and the improvement and adaptation of such measures for the more effective promotion of economic stability and growth.

There must be a common will to fight inflation and instability, and teamwork among government and private agencies in fighting them. Too often the different levels of government, the different agencies of the same government, and the different sectors of the economy are pulling against each other and preventing a unified and consistent course of action. Also too often there is lip service to preventing inflation or depression but at the same time there is an unwillingness to endure the sacrifices or other restraints needed for success in the battle against economic instability. To prevent inflation, excessive government, business, and consumer spending must be stopped and the supply of goods and services which are scarce must be increased to overcome the existing imbalances.

If increased government spending on defense, education, health, welfare, and other services is regarded as essential in boom periods, then the financing should be placed on a pay-as-you-go basis as fully as possible and inflationary borrowing should be avoided.

Even balanced government budgets, with taxes increased to support increased spending, may, however, be inflationary in boom periods. Total spending may be increased because funds which would otherwise not be spent are poured into the markets, the production of consumer goods may not increase so fast as it would if the funds were privately employed and keep up with the growing consumer demand, and costs may rise more when governments purchase than when private buyers are bidding for commodities.³ Substantial

³ Burns, *op. cit.* (note 1 *supra*), pp. 74-75.

budget surpluses, attained by tax increases if government expenditures are not reduced, may be required to produce an over-all anti-inflationary effect.

Government monetary, as well as fiscal, policies must be employed effectively if strong inflationary pressures are to be curbed. How effective fiscal and monetary policies may be in overcoming instability and promoting growth is uncertain. That they may be helpful cannot be denied.

Voluntary restraints must also be exercised by consumers, business, agriculture, organized labor, and other groups in their spending, saving, and economic activity if inflationary pressures are not

to be generated and maintained. Price fixing, short of war, is generally regarded as undesirable in this country. Even in times of war it is likely to be ineffective because it strikes at the symptoms, rather than at the roots, of inflation.

Reasonable stability of prices must be accepted as a national goal along with reasonable economic growth and social progress. It is too much to hope that economic growth and social progress can be sustained indefinitely by an unstable economy with an unstable price level. Steady growth and progress, as fast as our resources will permit, are all that we can reasonably ask.

The Federal Government's Weapons to Fight Inflation and Economic Instability

By JAMES A. MAXWELL

ABSTRACT: The federal government has never explicitly declared that prevention of inflation is its responsibility, and only recently has a strong opinion arisen that such a declaration should be made, possibly by amendment of the Employment Act of 1946. Some of those who desire price stability believe that, to achieve it, the federal government should add control over installment purchases and over major wage contracts to its repertoire. They feel that fiscal policy, depending upon Congress, is untrustworthy and that a tight monetary policy does not quickly reach important sectors of the economy. Opposition to federal assumption of responsibility for price stability comes especially from those who fear that its implementation will slow up economic growth. In their view, the "cost-push" is chiefly responsible for our recent inflation and for the prospect that creeping inflation lies ahead. It should be accepted as a fact of economic life, with some effort to mitigate its inequities through widespread extension of escalation. Such a step is, however, to be opposed both on grounds of equity and of theory. Widespread escalation is not feasible, and creeping inflation, if accepted as policy, will create economic disorder rather than accelerated growth.

James A. Maxwell, Ph.D., Worcester, Massachusetts, is Professor of Economics at Clark University. He is the author of several books and numerous articles in the field of fiscal policy. During World War II, he served in the Office of Price Administration and the Department of State.

THE federal government has never explicitly declared that prevention of inflation is its responsibility. But from the outset the dominant economic maxims, accepted by the two major political parties, have aimed at financial responsibility by government: the monetary unit should be tied firmly to the precious metals; budgets should be annually balanced; federal borrowing should be an emergency device.¹ Accordingly, after 1789, a bimetallic dollar was established; the large government debt resulting from the Revolutionary War was rapidly retired and, by 1836, completely extinguished. Under stress of the Civil War, the dollar became inconvertible and a new large federal debt was amassed. But when, after 1865, the nation was reunited, conservative fiscal and monetary principles once again brought about resumption of specie payments and rapid reduction of the federal debt. Financing of World War I was quite orthodox and so were the fiscal and monetary policies of the 1920's. Since 1929, however, a series of events has undermined many of the old rules. First came the great depression; and then, after World War II, came the cold war, the prospect of large

military outlay for decades ahead, success in abolishing depressions, and a lack of success in controlling inflation. As a result new and unusual federal economic policies are under discussion.

SECULAR PRICE CHANGES

Recently Professor George R. Taylor and Mrs. Ethel Hoover have presented an annual index of wholesale prices in the United States, 1720-1958.² Neglecting the period before 1789, Table 1 shows seven secular swings—four up and three down—in the 169 years, 1789-1958. Over this period, the price level increased nearly three and one-half times (the index for 1932 was, however, only higher by 11 per cent than that of 1789). Although these secular swings often aroused sharp political controversy, most statesmen and economists, until the Great Depression of the 1930's, viewed them with some complacency.³ The forces behind such swings were changes in the supply of gold and silver, or else a major war, and about them little could be done. And a similar complacency was manifested toward the shorter swings in the price level, attributable to the business cycle, because faith in the self-adjusting capacity of the economy was strong.

Creation by Congress of the Federal Reserve System in 1913 brought no shift in opinion. The objectives mentioned in the preamble of the Federal Reserve Act are limited: to furnish an elastic currency, to afford means of rediscounting commercial paper, and others. Only

TABLE 1—ANNUAL INDEX OF WHOLESALE PRICES IN THE UNITED STATES, 1789-1958

SECULAR SWINGS	YEAR	LOW [1850-59=100]	HIGH	PERCENTAGE CHANGE
1	1789-1814	94.0	184.4	+96.2
2	1814-1843	184.4	75.1	-59.3
3	1843-1864	75.1	220.9	+194.1
4	1864-1896	220.9	75.1	-66.0
5	1896-1920	75.1	249.3	+232.0
6	1920-1932	249.3	104.6	-58.0
7	1932-1958	104.6	296.2	+183.2

¹ A history of views and theories concerning fiscal policies is conveniently provided by Lewis H. Kimmel, *Federal Budget and Fiscal Policy, 1789-1958*. (Washington, D. C.: The Brookings Institution, 1959.)

² *Hearings of the Joint Economic Committee, Part 2, Historical and Comparative Rates of Production, Productivity and Prices*, 86th Congress, 1st Session, April 7-10, 1959 (Washington, D. C.: United States Government Printing Office, 1959), pp. 394-97.

³ Among economists, Irving Fisher was an exception. During the 1920's he was concerned about our unstable dollar and made unsuccessful attempts to get something done about it.

slowly did the System come to accept the broad objective of promoting economic stability, and only gradually were such objectives as "preventing injurious credit expansion and contraction" added by amendments. During the 1920's, indeed, an effort was made to write into the Act an explicit directive concerning stability of the price level by the Goldsborough Bill (H.R. 494, 68th Congress, 1st Session) and the Strong Bill (H.R. 7895, 69th Congress, 1st Session). The latter bill provided that "all the powers of the Federal Reserve shall be used for promoting stability in the price level." This the Federal Reserve opposed, arguing that it could not fulfill such a directive, that the directive was too narrow, and that prices were chiefly a result and not a cause of economic stability.⁴

Then came the great depression, and with it the focus of attention became employment and unemployment rather than the level of prices. With World War II, price stabilization temporarily became important in order to strengthen the war effort. But when, in 1945, Congress began consideration of post-war economic responsibilities, its interest again was employment. In the original version of the Full Employment Bill of 1945, the President, at the beginning of each regular session, was to send to the Congress a program which would "assure a full employment volume of production." Opponents declared that this meant federal guarantee of full employment, and, through their efforts, this provision, as well as the adjective "full," was removed from the Bill. The President was required merely to submit yearly an Economic Report setting forth current levels of em-

ployment, production, and purchasing power, and their foreseeable trends.

The Employment Act of 1946 specified a trilogy of objectives—"maximum employment, production, and purchasing power" (Public Law 304, Section 2)—which it is the responsibility of the federal government to promote. The commitment is, however, qualified, since what is done by the federal government must be "consistent with its needs and obligations and other essential considerations of national policy. . . ." The meaning of these words is not obvious, and, as Edwin G. Nourse, the first Chairman of the Council of Economic Advisers, has observed, the Act is "rich in ambiguity."⁵ Some economists have surmised, besides, that the three objectives may be incompatible and have been concerned as to which, in such case, should have priority; others have noticed and regretted the absence of a directive of price stability; and still others have been concerned at the lack of mention of economic growth. If the Act were to be rewritten today, it is very likely that stress would be given to growth with dynamic stability. Certainly these have recently been emphasized in the reports of the Council of Economic Advisers (CEA). It can be argued, of course, that the ambiguities of the Act with respect to economic objectives make it adaptable to whatever is the climate of economic and political opinion and that Congress has, after all, acknowledged its responsibility for achieving reasonable economic stability. But some people feel that this broad commitment is not enough, and that the Employment Act should be amended to express objectives which now seem more important than they did in 1946.

⁴The position of Benjamin Strong, the Governor of the Federal Reserve Bank of New York and the dominant figure in the System, is indicated in Lester V. Chandler, *Benjamin Strong, Central Banker* (Washington, D. C.: The Brookings Institution, 1958).

⁵*Papers and Proceedings of the American Economic Association*, May 1957. Edwin G. Nourse, "Ideal and Working Concepts of Full Employment," p. 100.

PRICE STABILITY

Congress in 1945-46 conceived and passed the Employment Act with the fear of postwar depression uppermost in its mind, and with no serious worry about the dangers of inflation. And until the Korean conflict, the CEA, in administering the Act, was not alert to inflation. Since then, and especially since 1956, the opposite charge has been made: that the CEA exaggerates the inflationary danger and therefore favors policies which retard growth.

Does the Employment Act offer any directive concerning price stability? Edwin G. Nourse declares that the objective of "maximum purchasing power" should be interpreted to embrace price stability. Others argue that "maximum purchasing power" is consistent with any level of prices and that, therefore, the Act is silent in this respect; and even if price stability is implicit, it might well be made explicit by amendment of the Act. Arthur F. Burns, Chairman of the CEA, 1953-55, has said:

I would urge an early amendment of the Employment Act, so as to make stability of the consumer price level an explicit and solemn objective of national economic policy, because I believe that this is the most effective action that the government can now take to arrest the dangerously spreading belief that we are living in an age of inflation.⁶

While such an amendment of itself would be simply a declaration of purpose, it would alert the CEA and the Joint Economic Committee of the Congress to pay closer attention to prices than in the past; it would

⁶ The American Assembly, *United States Monetary Policy* (New York: The American Assembly, 1958), p. 215; also Arthur F. Burns, *Prosperity without Inflation* (Garden City, N. Y.: Doubleday and Company, 1958), p. 71.

put private groups on notice that the government is determined to protect the dollar against further encroachment, and that the paths which governmental policy takes will depend largely on the moderation that business managers practice with regard to prices and that trade union leaders observe with regard to wages.⁷

A number of other economists have taken a similar position, averring that if an explicit directive had been in the original Act neither the Congress nor the CEA could have been so passive in the face of the inflation 1946-50. William McC. Martin, Jr., the Chairman of the Board of Governors of the Federal Reserve System, has recently stated that the Board "would favor an amendment which would make it explicit that national economic policy is concerned with preserving the purchasing power of the dollar."⁸

A subtle set of objections to such a step has been offered by those who stress the importance of economic growth. It may be that rapid growth, economic fluctuations, and price instability are somehow linked. Certainly growth in the United States has not proceeded smoothly: sometimes it has lagged; at others, it has accelerated. A dampening of economic fluctuations might retard growth and so might achievement of a stable price level.

"COST-PUSH" AND CREEPING INFLATION

These fears have been given point by the opinion that our recent inflation has been of the "cost-push" variety. Most past inflations in the United States have been "demand-pull," the immediate cause being that money demand for output outran the supply. Such an excess demand is general and not confined to

⁷ *Ibid.*, p. 215.

⁸ 85th Congress, 2nd Session, *Hearings on H.R. 12785, Amending the Employment Act of 1946, etc.*, p. 101.

a few products; it, therefore, brings about a rise in the price level. As a remedy, restrictive monetary and fiscal policies are indicated and will be effective. But considerable evidence indicates that our recent inflation stems from increases in costs—especially wage costs—which are independent of supply-and-demand forces to a considerable extent. Such a “cost-push” persuades sellers to raise their prices, and this process is the easier because price competition is not very intense. If it is objected that a general rise in prices requires an increase in the money supply, an answer is that, in the short turn, velocity will increase. While a rise in velocity has limits, it can be sustained long enough to enable a considerable price rise to take place. Indeed, the time lag is sufficiently great that, for practical purposes, the price increase will seem to be disassociated from the “cost-push” which caused it.

How restrain a “cost-push” inflation? The traditional instruments of monetary and fiscal policy will, so it is argued, be less than satisfactory. In order to be effective in checking inflation, they would have to be applied early in recovery. Such early restraint would slow up the rise of employment; it would moderate the pressure of labor for wage increases and also, through its pressure on profits, reduce the willingness of employers to yield to wage demands. But all of this would retard economic growth. As Sumner Slichter has said: “It is simply a proposal to subordinate growth to stable prices.”⁹ And he goes on to declare that most of the demerits commonly alleged against creeping inflation are erroneous, or exaggerated, or correctable. In short, he is willing to accept creeping inflation as the

easiest and best way to promote rapid growth, high employment, and abolition of depressions.

On the other hand, the case against creeping inflation is strong, especially if the inflation is planned and accepted as economic policy. The impact of a general increase in prices always has been uneven, and great injury has been inflicted on persons whose money incomes lag. The proponents of inflation would prevent or cushion this injury by extension of escalator clauses in wage, salary, and pension contracts and by adding such clauses to loan contracts. A vast escalator network would be spread over the economy. About this, four major questions should be asked: (1) Is such an extension feasible? It is hard to see that it is without a complete reconstruction of the present financial system of savings institutions, and this, if it is to be orderly, is a task of great complexity and delicacy. (2) If, by some alchemy, the extension could be made, would it not achieve the same market allocation as is now secured with a stable price level? (3) Can inflation be made to creep if escalation is widespread? At present, with limited escalation, the strong and strategic groups gain at the expense of weaker groups. Might not attempts to protect the weaker groups, which would serve to reduce the gains of the stronger groups, lead the stronger groups to reassert their power and therefore to speed up the whole inflationary process?¹⁰ (4) Does creeping inflation stimulate growth and high employment if it becomes a normal expectation of business and consumers? At best, the historical evidence is inconclusive because the United States has never experienced

⁹ 86th Congress, 1st Session, Joint Economic Committee Hearings, *Employment, Growth and Price Levels* (Washington, D. C.: United States Government Printing Office, 1959), pp. 9-13.

¹⁰ 85th Congress, 2nd Session, Hearings before the Joint Economic Committee, *Relationship of Prices to Economic Stability and Growth*, p. 196, where the First Report of the British Council on Prices, Productivity and Incomes is printed.

planned inflation. Rapid growth and rising prices seem coupled usually in periods either of war or of recovery from recession. In the former case, the combination of patriotic incentives and government controls produces results not to be expected in peacetime; in the latter case, the public expectation is not that prices will continue to rise.

CONTROL OVER INSTALLMENT PURCHASES AND WAGE CONTRACTS

If creeping inflation is rejected as an economic policy, some people believe that we will need to add new defensive weapons to the arsenal of the federal government. The two currently most discussed are: control over installment purchases and supervision—perhaps control—over major wage contracts.

In 1956, the Federal Reserve Board, at the request of the President, undertook a study of the need for stand-by authority to regulate the terms of installment purchases. "The evidence assembled through this study was inconclusive, and, consequently, no statutory enactment was either recommended or provided."¹¹ Many economists, nonetheless, believe that this control will be needed in the future because of the growing importance of consumer credit and because the instruments of monetary policy do not readily influence consumer credit. But it may be that the techniques used during World War II and the Korean conflict—specified minimum downpayments and maximum periods of payment—would not be adequate in peacetime to handle enforcement, and that new methods must be devised.

Another new weapon, designed particularly to combat the "wage-push," would require the CEA to report to the President concerning the anticipated

¹¹ Ralph A. Young, "Tools and Processes of Monetary Policy" in *The American Assembly*, *op. cit.* (note 6 *supra*), p. 32.

effects of proposed major wage contracts so that the President might recommend against them if they "would be contrary to economic stability."¹² This step is opposed by many as the beginning of a process which would lead to federal control over the collective bargaining process, and it is unlikely at present to receive much consideration.

FISCAL POLICY AND DEBT MANAGEMENT

Recently most of the responsibility for economic stabilization has fallen to monetary policy. And yet a decade ago, not to say in the 1930's, economists expected that fiscal policy and debt management would provide significant assistance.

By fiscal policy is meant the use of government expenditure and revenue as balancing factors to add to or subtract from aggregate demand so that surpluses are generated in order to restrain boom and deficits to dissipate recession. Belief in the potential of fiscal policy remains strong, but many doubts have arisen concerning its practical utility in our political and institutional set-up. Some solid achievements for fiscal policy can, however, be claimed because of the operation of built-in flexibility. Federal revenues, when allowed to operate by Congress without new legislation to change existing provisions, tend automatically to produce deficits in recession and surpluses in prosperity. The tax obligations of individuals and corporations under income tax are sensitive to cycles. Some federal expenditures, notably unemployment benefits, show a similar built-in flexibility. On the other hand, exercise by Congress of its discretionary power to alter tax provisions and expenditures has not conformed clearly to the principles of fiscal policy.

¹² 85th Congress, 2nd Session, *Hearings on HR 12785, Amending the Employment Act of 1946*, etc. (Washington, D. C.: United States Government Printing Office, 1958), p. 9.

The two major postwar tax reductions in 1948 and 1953 were inspired and dictated less by fiscal policy than by political considerations, and it was a lucky accident that, in part, their impact was countercyclical. In the postwar years, Congress has, over-all, displayed a bias in favor of expansive action, and this means that it has enhanced inflationary pressures.

If Congress could be persuaded to give the Executive some limited power to alter tax rates for countercycle purposes, this bias might be removed. But Congress is understandably jealous of its fiscal prerogatives not only because of fear of Executive aggrandizement, but also because of scepticism concerning how fiscal policies would operate. What would be the effective weight of a two-point change up or down in the beginning rate of the individual income tax, or of a \$100 change in the per capita exemption? Until more quantification of possible fiscal policy actions is provided, Congress will be hesitant to place new power in the hands of the Executive.

The outlook for countercyclical use of debt management is even more discouraging. The standard theory is that government should issue long-term securities as an anti-inflationary step, and short-term ones as an anti-recessionary step. While this theory has not been articulated in detail, it may be doubted that debt management can do anything that monetary policy cannot do.¹³ In any case, countercyclical debt management runs into the important practical fact that it would enlarge the interest costs of the Treasury. This is so because interest rates on long-term securities tend to be high in prosperity; that is, at the very time when the theory dictates that they be issued. Enlarging the interest

cost is politically distasteful, and, aside from stabilization, of no economic merit. The Treasury will, indeed, usually be glad to issue short-term securities in recession.¹⁴ It will issue long-term ones when the money market is favorable, with little regard to countercycle effects.

CO-ORDINATION OF ECONOMIC POLICIES

Responsibility for operating our two major economic controls is split: monetary policy is assigned by the Congress to the Federal Reserve System, a body which is independent of the Executive, and fiscal policy rests with the Congress. A good many federal departments and agencies, besides, carry on lending and loan-insuring activities which have a distinct effect on cyclical conditions, and these activities are often not subject to direct control by Congress, the Executive, or the Federal Reserve. The Council of Economic Advisers in the Executive branch, and the Joint Economic Committee in the Legislative, are meant to provide a co-ordinating machinery, and they have served this purpose. But the powers of both are limited and have depended largely upon the personality of the chairman of the CEA and of the Joint Economic Committee. Under the Eisenhower Administration in 1953, an Advisory Board on Economic Growth and Stability was established, chaired by the chairman of the CEA, with membership from the chief spending departments, the Bureau of the Budget, and the Federal Reserve Board. Meeting weekly, its aim is to advise the CEA of governmental activities affecting the economy.

Perhaps an informal organization of this sort with advisory powers is enough.

¹³ See Herbert Stein, "Managing the Public Debt," *Journal of Law and Economics*, Volume 1.

¹⁴ In February and May, 1958, the Treasury issued some intermediate and long-term securities because, in the last few years, the occasions when the market would accept long-terms were rare.

But sceptics raise such questions as: What if an agency disregards advice? What if an outright conflict in economic policy should arise? The collision between the Federal Reserve Board and the Treasury in 1950-51 provides a case in point. In the years after 1946, the Board became increasingly restive over its commitment to support the prices of federal bonds and, in 1949, it was receptive to the idea that a Monetary and Credit Council be provided, hoping thereby to secure backing for a break-away from Treasury dominance. The Treasury, however, was not then interested. But when, in 1951, the Federal Reserve Board was successful in securing its independence, it lost interest in a Council. The Treasury,

on the other hand, began to see merit in such a body.

Here the matter rests, and so long as the economic peace is not disturbed by a depression or by a falling-out of the Federal Reserve and the Treasury, interest in creating a formal board, with the duty of co-ordinating federal economic policies, will be slight.¹⁵

¹⁵ Mention should be made of the opinion expressed most cogently by Professor Milton Friedman that discretionary monetary policy should be replaced by an automatic monetary policy which would provide us with a stable and continuous growth in the money supply. A popular statement of this position is provided by Edward S. Shaw, "Money Supply and Stable Economic Growth" in *The American Assembly*, *op. cit.* (note 6 *supra*), pp. 66-71.

The Need for Balanced Federal Budgets

By MAURICE H. STANS

ABSTRACT: It should be the policy of the federal government to aim always for a balanced budget or financial stability will be upset. To balance the budget, action should be taken to reduce or end some federal programs which we have been acquiring in the past thirty years. The compensatory theory of federal spending has not been successful until now and offers little hope for the future unless there is control in the growth of federal spending. We should not initiate programs as temporary expedients during times of recession since they create great problems in future years. Although we must accept deficits when the country is in a national emergency, we should later create equivalent surpluses to offset deficits caused by the emergency. It is, therefore, necessary to pay as we go if we want to reduce the national debt and taxes. It is also necessary to plan for budgetary surpluses in good years if we do not want to extend inflation in the future.—Ed.

Maurice H. Stans, LL.D., Washington, D. C., is Director of the Bureau of the Budget. Formerly he was Financial Consultant to the Postmaster General and Deputy Director of the Bureau of the Budget. Mr. Stans was previously executive partner in the national accounting firm of Alexander Grant and Company. He is a member and former President of the American Institute of Accountants, member and former Director of the Illinois Society of Certified Public Accountants, and member of the National Association of Accountants, the American Accounting Association, the Federal Government Accountants Association, and the American Society for Public Administration.

THE federal government should have a balanced budget; its expenditures, especially in times like these, should not exceed its income. Of this I am deeply convinced.

As a matter of fact, I find it difficult to understand why there are still some people who do not seem to agree. Even though I have now been an official of the government almost four years and know by hard experience that there are at least two sides to all public questions, on this one the facts speak eloquently for themselves. And the arguments that are marshalled in opposition to show that a balanced budget is unimportant—or that it can be safely forsaken for lengthy periods of time—certainly seem unsound. It is true that we as a nation have been extremely fortunate in maintaining our fundamental strengths thus far despite the heavy deficit spending of the past thirty years. But we cannot count on being lucky forever, and more and more the consequences of past profligacy are now catching up with us.

Let us look at some of the facts:

1. It is a fact that in 24 of the last 30 years the federal government has spent more than it has received.

2. It is a fact that last fiscal year the federal government had a deficit (12.5 billion dollars) larger than ever before in time of peace.

3. It is a fact that the federal government debt is now 290 billion dollars and that the annual cost of carrying that debt is more than 10 per cent of the budgeted income of the government—and has been going up.

4. It is a fact that our economy is operating at a higher rate of activity than it ever has before and that the standard of living it is producing for all America is far beyond that of any other country in the world.

5. It is a fact that in times of high economic activity there is competition among business, consumers, and gov-

ernment for the productive resources of the country; if government, by indulging in high levels of spending in such times, intensifies that competition, it openly invites inflation.

6. It is a fact that with an unbalanced budget, federal borrowings to raise the money to spend more than income tend to add to the money supply of the country and therefore are inflationary.

7. It is a fact that the purchasing power of the dollar has declined more than 50 per cent in the last twenty years. Today we spend more than \$2.00 to get what \$1.00 would buy in 1939.

8. And finally, it is a fact that all too often in history inflation has been the undoing of nations, great and small.

True, there are many people who still feel that a bit of inflation is a tolerable, if not a good, thing. I think they fail to see that a bit of inflation is an installment on a lot of inflation—a condition in which nobody can hope to gain.

Those of our citizens who believe that inflation is not undesirable simply overlook the history of nations. Inflation is an insidious threat to the strength of the United States. Unless we succeed in exercising a tighter rein over it than we have been able to up to this point, I am afraid that we will all lose—as individuals, as a nation, and as a people.

In my view, the facts that I have cited clearly demonstrate the need for:

1. Containing federal expenditures within federal income—which means balancing the budget—in fiscal years 1960 and 1961.

2. Establishing the principle of a balanced budget—including some surplus for reduction of the national debt—as a fiscal objective for the prosperous years ahead.

These are the standards on which fiscal integrity for the nation should rest. These are the standards by which the force of inflation induced by reckless

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fiscal policy can be averted. Yet in 24 of the last 30 years we have not been able to attain them.

Let us look at some of the circumstances which have caused heavy federal spending in the past and have, perhaps, made us insensitive to the dangers of deficits.

LOOKING BACK

Over the last three decades the federal government has spent 264 billion dollars more than it has received. The six years in which there was an excess of income over expense produced negligible surpluses in relation to the deficits of the other years.

We need hardly be reminded of the cause of most of those deficits. In the earlier years it was depression; in the middle years it was war; in recent years it has been war again and then recession.

In the depression years it was not possible to balance the budget; while government services and costs were growing by popular demand, federal revenues declined as a result of economic inactivity. The efforts made to balance the budget by increasing tax rates in 1930 and 1932 and in 1936 to 1938 were apparently self-defeating.

As for the expenditure side of the budget, the decade of the 1930's produced a great deal of talk about "pump-priming" and "compensatory spending"—federal spending which would compensate in poor times for the decline in business and consumer demand and thus lend balance and stability to the economy. The theory was, of course, for the federal government to spend proportionately larger amounts during depression times and proportionately smaller amounts during good times—to suffer deficits in poor years and enjoy surpluses in prosperous years, with the objective of coming out even over the long pull.

Then, in the early 1940's came World

War II. During the war years, the federal government's expenditures vastly exceeded its income, and huge further deficits were piled up. In retrospect, most students of wartime economic developments now agree that we did not tax ourselves nearly enough. We did not pay enough of the costs of war out of current income. We created a large debt while suppressing some of its inflationary consequences with direct economic controls, but the suppression was only temporary.

Depression and war, although major factors, were not the only reasons for increased federal expenditures and deficits during the past thirty years. It was more complex than that. In the 1930's the national philosophy of the responsibilities of the federal government underwent a major change. The country's needs for economic growth and social advancement were gradually given increased recognition at the federal level.

The aim of economic growth, of social advancement, and of "compensatory" economic stability became intertwined. Many federal activities of far-reaching implications were established in ways which affected federal expenditures for very long periods of time—if not permanently. Social security, greatly increased support for agriculture, rural electrification, aids to homeowners and mortgage institutions, public housing, public power developments like the Tennessee Valley Authority and other multipurpose water resource projects, and public assistance grants are just a few examples. All of them, however, remained as federal programs after World War II. And we were actually fighting in that war before federal spending for work relief could be stopped.

The immediate postwar period was marked by dramatic demobilization. Nevertheless, many of the major costs of war lingered on. The maintenance

in the postwar period of even the reduced and relatively modest structure of our Armed Forces was far more costly than anything that existed in the way of the machinery of war prior to 1940. The war also left us with greatly increased expenditure commitments for interest on the public debt, for veterans, and for atomic energy. The Marshall Plan and the mutual security program followed in succession. It became obvious, next, that the cold war was going to be expensive. Then, with the Korean aggression, it became necessary to rearm and, even after the shooting stopped, the peacetime striking force and defensive machinery we had to maintain continued expenditures at levels that far exceeded in cost anything we had earlier imagined.

Thus, the postwar growth of the budget has been partly in the area of national security, partly deferred costs of World War II, and partly the inheritance of activities and ways of thinking that characterized the depression of the 1930's. We have now learned that many of the programs the federal government initiated in the 1930's were neither temporary nor "compensatory" in character. Moreover, we have not only retained many of them, but we have also greatly expanded them in the postwar period. Since World War II we have seen large increases in federal expenditures for urban renewal, public health, federal aid for airports and highways, new categories and a higher federal share of public assistance grants, aid to schools in federally impacted areas, great liberalization in aid to agriculture, as well as new programs for science, education, and outer space.

THE PRESENT

What can we conclude from all of this?

It seems to me that in the first place we must recognize that the compensa-

tory theory of federal spending has failed thus far and offers little hope for the future unless we exert a more forceful and courageous determination to control the growth of federal spending. The major spending programs which originated in the depression years have in most cases persisted in the following decades. A work relief project could be turned off when we started to fight a war, but most of the programs established in the 1930's developed characteristics of a far more permanent sort.

An example can be found in the program of the Rural Electrification Administration (REA). This program was started in 1936 when only a minority of farm families enjoyed the benefits of electricity. Today, 95 per cent of our farms receive central station electric service. We have invested 4 billion dollars in this program, at 2 per cent interest. Nonetheless, indications are that future demands for federal funds will be even greater as the REA co-operatives continue to grow.

The startling fact is that three out of four new users currently being added are nonfarm users. About one-half of REA electric power goes to industries, communities, or nonfarm families. The reasonable approach is that rural electric co-operatives should now be able to get some of their financing from other than government sources, especially for nonfarm purposes that compete with taxed private industry. Recognizing this, the President last year—and again this year—recommended that legislation be adopted to encourage co-operatives to switch from government to private financing, and his budget recommended a decrease in the funds for government loans. These proposals were not enacted by the Congress.

Inability to turn off expenditures is not all that is wrong with the compensatory theory of the prewar period. Initially, it dealt largely with the spending side of the fiscal equation whereas the

income side now appears to be playing a more important part. Today—with corporate income tax rates at 52 per cent—any substantial reduction of corporate earnings produces an immediate proportionate and large loss to the federal treasury. Personal income taxes also respond, though less sharply, to a fall in national production and employment. Thus, when times take a turn for the worse, federal revenues decline promptly and substantially.

Couple this with enlarged social obligations in times of recession or depression—unemployment compensation, public assistance, and so on—and you have substantial leverage of a more or less automatic character for the production of federal deficits in times of depressed economic activity. To do more than this—to deliberately step up expenditures still more, for public works and other construction, as was done last year—runs grave risks. There is, first, the risk that an antirecession expenditure program cannot be turned off after the recession, but instead represents a permanent increase in the public sphere at the expense of the private. Second, it is difficult to start programs quickly, so the major impact may come long after the need for the economic stimulation has passed. Both of these risks mean that antirecession actions can well represent an inflationary danger for the postrecession period. The danger is there even if, as some believe, positive governmental intervention is required to counter recessions. It is more grave, however, if—and I believe this was proved true in 1958–59—the economy is vigorous and resilient enough to come out of a temporary recession and to go on through a revival period to new prosperous peaks without any direct financial federal interference.

I think we may conclude that it is inevitable that our nation will be faced with large budgets in the years ahead. This is particularly true for the defense

obligations which our country has assumed, for its international undertakings to provide economic and military assistance to other free nations, and as a result of many programs which have been started over the years—major programs for water resource development, agriculture, veterans' benefits, low-cost housing, airways modernization, and space exploration—all these and many others have taken on a permanent quality which makes it clear that federal budgets will be large budgets in our lifetimes.

There is still another conclusion which springs from this short recitation of the history of the last thirty years. It is that the federal government has assumed more and more responsibility for activities which formerly were regarded as being under the jurisdiction of state and local governments. More and more the federal government has assumed responsibility for public assistance, housing, urban renewal, educational aid to areas with federal installations, and many other programs that are now supported by federal grants-in-aid to the states. All this, of course, contributes to the conclusion that these federal programs are not only large at the present time, but have a built-in durability—a staying power with which we must reckon as a fact of life.

I think these thoughts are well summarized in the words of Mr. Allen Sproul, former President of the New York Federal Reserve Bank, who recently said:

Government, in our day, touches upon the economic life of the community in an almost bewildering variety of ways, but its overall influence comes into focus in the consolidated cash budget and, in a subsidiary way, in the management of the public debt. When we abandoned the idea of taxation for revenue only and admitted, as we must, a more important role of Government in economic affairs, we thought up a tidy little scheme called the compen-

satory budget. This envisaged a cash budget balanced in times of real prosperity, in deficit in times of economic recession, and in surplus in times of inflationary boom. What we have got is a budget that may throw up a shaky surplus in times of boom, but that will surely show substantial deficits in times of recession. The bias, over time, is toward deficits, with only wobbly contracyclical tendencies.

LOOKING AHEAD

It seems to me that as we move into another decade it will be essential to recognize that unless we have a more positive program for operating our federal government within its income, the forces that have gained such tremendous momentum in the past will perpetuate the tradition of deficits—to the great disadvantage of the country as a whole.

Assuming a continuous, but not uninterrupted, economic growth for the country, accompanied by ever-increasing, but not uninterrupted, growth of federal revenues, we should nevertheless expect that the growth of programs started in the past will have a strong tendency to absorb the expected additional revenues—unless aggressive controls are exercised by an alert administration and a statesmanlike Congress during those years.

On those occasions when the economy recedes from its way of growth, we must expect great leverage to be exerted toward the building up of additional deficits. We must learn to live with recession-induced deficits as a matter of necessity, but we should not take unneeded actions which mortgage our nation's future with both more debt and an inflationary potential.

CONCLUSIONS

It seems to me to follow from these facts and analyses that it should be the

policy of the federal government to strive determinedly for a balanced budget at all times, for, clearly, if it does not, the forces at work to upset financial stability will surely prevail as a matter of momentum.

As we move into the next decade we have the lessons of the three past decades to guide us:

1. Federal programs persist and in most cases grow. As demand expands, the programs expand. It is extremely difficult to curtail them. Their growing costs—and a growing economy—must be reckoned with realistically. This means that actions should be taken to reduce or to end them as they accomplish the purposes for which they were initiated (eighteen such proposals were made in the President's budget message for the fiscal year 1960).
2. In times of recession, it is important to avoid doing things as temporary expedients which will become longer range programs and create major problems later on. We have plenty of these as carry-overs from earlier days; we should avoid creating new ones for the years ahead.
3. We must, of course, learn to live with deficits when major national emergencies threaten or exist in our country. But we should resolve to create equivalent surpluses later on to offset such deficits.

The lesson is clear. We should pay as we go, and if we are to look for debt reduction or tax reduction on a sound footing—as we should—we must do more than this. We must plan for substantial budgetary surpluses in good years—or we will surely contribute to further dangerous inflation in the years ahead.

Social and Economic Growth Without Inflation

By GERHARD COLM

ABSTRACT: There is no clear correlation between the rate of economic growth and price developments. Very rapid expansion is usually associated with price rise, a business slump with price drops. In the wide range between these extremes, growth may be associated with rising, stable, or falling prices. This is explained by the great variety of factors influencing prices, often working in opposite directions. Since there are multiple causes of price rises, there are also several policies which should be combined to combat price rises. They include: positive policies designed to increase productivity and to overcome obstacles to greater production; more effective credit policies to combat demand inflation; and arrangements designed to articulate the public interest in price and wage developments as a means to restrain cost increases.

Gerhard Colm, Dr. rer. pol., Washington, D. C., is Chief Economist of the National Planning Association and Professorial Lecturer at George Washington University. He served with the Budget Bureau and Council of Economic Advisers in the Executive Office of the President from 1940 to 1952. Dr. Colm is author of The American Economic in 1960 (1952), Essays in Public Finance and Fiscal Policy (1955), and co-author of The Economy of the American People (1958) and author of other books and articles.

THE topic suggests that there is a question as to whether or not it is possible to have social and economic growth without inflation. Several writers, Sumner Slichter the foremost among them, have contended, indeed, that we have to choose between a satisfactory rate of economic growth and reasonable price stability; that some continuing price rise is the price we have to pay for adequate economic growth; and that only inadequate or spasmodic growth is compatible with price stability. This view holds that continuing economic growth and high employment are higher priority national objectives than price stability and that, therefore, we have to learn to accept some degree of permanent inflation.

Others fear that the expectation of even a continuing small degree of inflation may lead to an increasing degree of inflation. They are inclined to choose the other alternative, namely to be satisfied only with a smaller or discontinuous rate of growth which is compatible with price stability. In the terms of this alternative, we have to live with less than full utilization of our technological and managerial potentialities and periodically also with less than full employment.

It will be the thesis of this article that these alternatives of either adequate growth with inflation or inadequate growth without inflation represent a gross oversimplification of the problem. Inflation is a problem we have to face irrespective of whether the rate of growth is or is not adequate. Although policies designed to promote economic growth may conflict with policies designed to promote price stability, such conflict is neither inevitable nor unavoidable. Rather what is needed is a reconciliation of these policies. The relationship between growth and inflation is more complex than is implied by

the dilemma between the objectives of growth and stability.

PRICE AND COST BEHAVIOR IN THE BUSINESS CYCLE

The simplified view that prices in a period of expansion rise and in a period of slack decline with some possible long term stability as an average requires considerable qualifications. In the following argument I assume a cycle with alternating periods of expansion and slack, an assumption which in itself requires qualification.

In a period of expansion, prices often rise because optimism leads business to revise its investment plans upwards and consumers to increase debt financed purchases. The resulting claims on resources may lead to price rises through the so-called "demand-pull" inflation, particularly in basic industries. The high level of activity may raise profits so much during the expansion period (because of lower overhead costs per unit of sale) that despite increases in costs, business may not raise prices as far as would be likely if "what the market can bear" were the sole criterion of price determination.

To the extent that prices in basic industries do increase in this period of intensive demand, they affect costs of the processing industries sooner or later. The price rise in the basic industries may become a serious "cost-push" in other industries at a time when the excess demand has disappeared. This is one way in which the "demand-pull" of the expansion phase may become a "cost-push" in a subsequent stagnation phase of the cycle.

In a period of economic slack or inadequate expansion, basic industries working at a low rate of operation are faced with a rise in unit costs of their product and a severe fall in profits. Since industries depend to a consider-

able extent on earnings for the financing of their modernization of plant and equipment, they have a strong incentive to raise prices. Firms in the "administered price" field which have postponed a possible price rise during the expansion period may choose to increase prices in the slack period of the cycle. In certain other industries a price rise, even in a period of some slack, may result in mitigating the decline in profits even if the price rise deters some customers. At least there will not be the price decline which takes place in industries of higher price elasticity and more nearly perfect competition. In a period of economic slack the effect of these cost-raising tendencies may be offset by price declining tendencies due to inadequate markets. In the event of a recession, a general stability of the price level, therefore, may result from offsetting tendencies of raising and lowering prices.

During a period of economic growth and rising profits, labor demands and may be granted substantial wage increases. In order to maintain its profit position, business may increase prices in proportion to, if not by more than, the increases in real labor costs—that is wage increases in excess of wage saving due to technological and managerial advances. Wage increases in some industries sooner or later affect wage scales in other industries with little productivity gains. As was the case with other cost increases, wage rate increases originating in high-profit industries during an expansion period may hit other industries after the expansion period has come to an end and may exert a "cost-push" effect on prices.

Because of this rather complex relationship between price and cost developments in periods of expansion and slack, there is actually no clear statistical correlation between the rate of economic growth and the price develop-

ment.¹ Admittedly, our reasoning is of a speculative nature because our knowledge about the behavior of prices and costs in the cycle is still incomplete. Nevertheless, available statistical observations do not conflict with our hypothesis. From these arguments may be derived the following rules of thumb concerning price and cost behavior.

A very rapid economic expansion (forced draft) is likely to be associated with a substantial price rise (unless suppressed by price controls). Rather arbitrarily and simply to indicate an order of magnitude, I would say that a rate of growth of more than 5 per cent per year could not be sustained for long in the United States without causing considerable price pressure.

In the event of a serious and long lasting economic set back, the effects of shrinking markets are likely to prevail over the effects of the cost increases with a substantial price fall as a result.

Within a rather sizable range of potential growth rates, no general statement about price developments can be made. That is to say, within that range there would be no clear correlation between the rate of growth and a rise in prices. Depending on a number of factors other than the rate of economic growth, prices may rise moderately, substantially, or not at all, or may even decline.

AN UNSOLVED PROBLEM

Throughout the history of economic thought, attempts have been made to explain the rise and fall in prices by reference to a single causal factor. Each of these explanations was based on observations valid in some situations but proved wrong in others. One of the

¹ Otto Eckstein, "Inflation, The Wage-Price Spiral and Economic Growth," *Joint Economic Committee Study of the Relationship of Prices to Economic Stability and Growth*, March 31, 1958 (Washington, D. C.: United States Government Printing Office, 1958).

most convincing explanations suggested was that the price level is determined by the amount of money in circulation. At one time the rise in prices following an influx of gold, or following the creation of paper money, seemed to validate this theory beyond doubt. And yet without taking into account the effect of the velocity of circulation on the price level, this theory proved to be inadequate. The velocity of circulation is subject to erratic changes; therefore the usefulness of the quantity theory of money as an explanation and as a guide for policy is limited to situations with a truly massive change in the quantity of money.

Another theory of price behavior proposes that it is the government deficit that causes inflation, a government surplus that causes price declines. This theory is borne out by the experience of wartime inflation, but in other periods no such simple explanation proves to be valid. During the calendar years 1947, 1948, 1956, and 1957 the federal government experienced substantial cash surpluses, while at the same time a substantial price rise was taking place. In 1953, with a big deficit, there was reasonable price stability. Also, the price stability during the recent recovery—from Spring 1958 to the Spring 1959—occurred in a period of a large government deficit. Such experiences contradict these simplified theories of direct causation.

A new monistic theory has been advanced recently by Sidney Weintraub² in which he undertakes to prove that wage rate increases are virtually the sole determinant of price changes. This theory again is in accord with the facts in some situations but is refuted by the facts in others.

² Sidney Weintraub, *A General Theory of the Price Level, Output, Income Distribution and Economic Growth* (Philadelphia, Pa.: Chilton Co., 1959).

The century-old attempt to explain the movement of prices by reference to any one single factor should be buried forever. This attempt is as futile as an attempt to explain changes in the body temperature by any one single bacillus. On the other hand, the fact that neither changes in the quantity of money, nor government deficits, nor wage rate increases, nor changes in the rate of growth can adequately explain a change in prices does not mean that these factors are unrelated to the price development. On the contrary, an analysis of prices must take all these factors into consideration. Sometimes one factor, sometimes another is predominant. Accordingly, policies designed to promote price stability cannot deal with only one of these factors but must use a variety of measures depending on the specific situation.

THE POLICY CONSEQUENCES

The main consequence of this analysis is that the monistic policy approach to price stability is as deficient as the monistic theoretical approach. There is a widespread opinion that a price rise—whether originating from the cost or demand side—can always be prevented by appropriate monetary policies. This would be the case if a price rise, irrespective of its prime causes, depended on monetary expansion at least as a secondary cause. The argument is that a price rise must at least be validated by an increase in the money supply, disregarding possible changes in velocity. If, in the face of an upward pressure on prices, no increase in the money supply takes place, prices cannot rise or else a shrinkage in the market and unemployment will result. This shrinkage in markets, so the argument runs, would in time bring prices down. Thus, a restrictive monetary policy in order to prevent a price rise or force a price reduction may lead to a recession. Pos-

sibly a real recession of considerable severity and duration would be needed to counteract the upward pressure on prices.

Using monetary restraint as a remedy against inflation is justified under conditions of excessive demand. In such instances, a restrictive monetary policy is designed to operate through the market by curtailing demand to a point where it is in approximate balance with available production. If, however, it is also used to combat a price rise resulting from rising costs of materials or labor, a more drastic curtailment is needed and the economic effect of the medicine may be worse than the disease.

Therefore, a policy designed to promote economic growth and price stability must move on several fronts at the same time.

First, measures can be adopted which at the same time promote both economic growth and relative price stability. Private and public measures which increase productivity not only support economic growth and increase the supply of goods and services but thereby aid in counteracting inflationary tendencies. Such measures include efforts in support of research, technological development, education, training, provision for adequate aids to transportation and communication, development of resources—for example, water—and so on. Also, removing obstacles to productivity—for example, featherbedding—fosters economic growth and price stability. In addition, by promoting full employment conditions, an economic climate is created in which business is inclined to set lower prices in expectation of relatively high levels of operation; and labor is inclined to accept the introduction of technological advances in expectation of continued high levels of employment. We have come to identify anti-inflation policies largely with restrictive measures. And

yet the most effective anti-inflation policies are of a positive character and are largely those policies which support economic productivity and economic growth.

Second, there is also need to be prepared with restrictive measures. If, for example, a large increase in national security expenditures threatens to create inflation, restrictive measures would be needed to check the increase in private demand. In another instance, economic expansion may require a promotion of demand. If, however, such policies are overdone, inflationary pressures may be created. Also, a period of balanced expansion may generate optimism and may lead to speculative overexpansion, for example, in plant and equipment, or business inventories, in stock or real estate buying, residential construction, or in consumer installment buying. Such excesses may create imbalances and, if occurring on a broad front, may lead to "demand-pull" inflation. Measures to deal with such situations include special and general credit controls.

Of particular importance and difficulty is the need for measures which influence business investment. The largest part of business investment is financed from internal business sources—undistributed profits, depreciation and depletion accruals. Available monetary and credit controls have no direct—and at best only some indirect—effect on the accrual and use of these business funds. Proposals have been made to use flexible tax devices either to encourage or to discourage the active use of these internal business funds. None of these proposals has yet found serious legislative consideration. Until a satisfactory solution of this problem has been found, the control of booms by monetary policy will not be very effective and will be, in effect, discriminatory. Monetary and credit restraint

exerts a more severe impact on young and small businesses than on seasoned and large enterprises; it adversely affects housing unless offset by special credit measures; it also discourages local government undertakings. This discriminatory effect of restrictive credit policies, in addition to its other undesirable aspects, diminishes the political acceptability of the stringent use of general credit controls.

Credit controls and the public debt

There is another aspect of monetary regulation which ought to be mentioned. The operation of credit controls has been complicated by the fact that it is inextricably tied up with the management of the large public debt. Inflation during World War II was held down by direct controls, and credit policy was conducted primarily with the view of supporting war finance. Continuation of this easy monetary policy after the war severely reduced the possibility of using credit policy as an anti-inflationary device. The "accord" between the Treasury and the Federal Reserve in March 1951 was understood to initiate a policy which would reconcile the need to support an orderly market for government securities with the need to foster price stability. Recently, the Federal Reserve has pursued a policy motivated primarily by the fear of inflation and without much regard for conditions in the government security market. During the recent Congressional debate on debt management—in connection with the President's request for removing the interest ceiling on federal bonds—proposals were made that the Federal Reserve pursue a policy which at times would lend support to the government securities market without jeopardizing the flexibility of the Federal Reserve to combat inflation. Such a policy, for example, could utilize open market operations to facilitate

debt management but could limit the expansionary effect of such transactions by raising bank reserve requirements. Improvements are certainly needed in the ability of the Federal Reserve to regulate the flow of credit in a manner which supports economic growth without creating excess demands. The Monetary Commission which has been established with the aid of the Ford Foundation can be expected to make recommendations in this respect.

Third, as was pointed out above, a restrictive credit policy cannot effectively resist the "cost-push" type of price rise. To do battle effectively in this situation requires a policy which can take account of such factors as limited competition, administered prices, and wage rate increases in excess of productivity gains. How can increases in costs of materials which are not the result of scarcities be prevented? How can increases in wage rates which are out of line with general productivity gains and which are not justified on social grounds—substandard wages—or on special economic grounds—labor shortages in bottleneck industries or bottleneck areas—be prevented? One of the most important tasks of economic policy is to bring price and wage determination under conditions of imperfect competition in line with economic growth and price stability objectives—without resort to warlike price and wage controls. This task again requires a combination of measures. Policies which prevent the abuse of private economic power would help. Foreign competition can be a very effective check on a domestic price rise. Also, policies would be helpful which promote competition not only within an industry but also among substitutable products or services—for example, synthetic building material vs steel; air freight vs rail freight.

But, perhaps the most important ele-

ment for curbing unreasonable price or wage demands is a public opinion which forces business and labor to consider the general interest in the pursuit of their private interests. That business and labor find public opinion important may be demonstrated by the large amounts spent for advertising their side of the story in conflicts like the recent steel negotiations. However, this "power of the public" could be mobilized in a more systematic and effective manner. Proposals such as those recently made by Congressman Reuss and Senator Clark for amending the Employment Act of 1946 give expression to this objective. They propose public hearings in case of price and wage increases, actual or intended, in crucial industries. In the case of wages, hearings would be called only if wage increases in the opinion of the firms concerned would force prices up. There is room for discussion as to the best arrangement for conducting such hearings. None of the proposals made would prevent the parties from going ahead even with economically undesirable price or wage changes. Price or wage controls have not been proposed in this connection. Nevertheless, the idea of public hearings is important because it dramatizes the fact that price and wage determinations in these cru-

cial cases are not merely a private affair of those directly concerned but are also a matter of legitimate public concern. Articulating this public concern in such a way that business and labor take it into account is probably the only alternative to more drastic measures of government interference.

SUMMARY

In summary, a reasonable rate of economic growth and a reasonable degree of price stability are compatible objectives. To a large extent, the same policies will serve to promote both objectives. The problem of inflation in the modern economy is serious irrespective of whether a somewhat greater or smaller rate of growth is held desirable. Meeting this inflationary "bias" in our economic system requires institutional arrangements which should be designed to articulate the public interest in private decision making. More important than the adjustments in institutional arrangements, however, are the needed adjustments in the attitudes of private decision makers. It is not utopian to expect that these adjustments will be made; they are already in the making. Economic growth without inflation is not a contradiction in concepts as some maintain; rather it is a necessary realizable objective of a free society.

What Would Labor Do About Inflation?

By GEORGE MEANY

ABSTRACT: The major needs of our time are adequate national defense, public services for a growing population, comprehensive economic and technical aid for the uncommitted peoples of less-developed areas of the world who are emerging from colonial domination and social and economic adjustments to rapid technological change. These needs must be met for national survival and the continued progress of our free society. They can and should be met by economic expansion of at least 5 per cent a year. Restrictive economic policies that curtail economic progress and growth must be abandoned. The "tight money" policy should be halted if growth is to be stimulated. Continuing wage and salary increases should be encouraged if growing consumer markets are to be attained. The government's budget policy should aim at balancing the budget in times of full employment from an expanding economy rather than restricting government expenditures and retarding economic growth. Full employment and economic growth of 5 per cent a year should be established as basic national objectives, to be implemented by government policies. To achieve these major requirements, there should be an end to the incessant propaganda campaign about runaway inflationary pressures that have not existed in the past eight years. Solutions for the type of price changes of recent years have to be developed on the basis of the facts in each separate part of the economy. The main task of the day is more rapid economic expansion to sustain full employment and meet the nation's needs. This will do more than anything to stabilize the price situation.

George Meany, Bethesda, Maryland, is President of the American Federation of Labor-Congress of Industrial Organizations. Formerly, he was President of the New York State Federation of Labor, 1934-39 and Secretary Treasurer, 1940-52 and President, from 1952 of the American Federation of Labor. During World War II, Mr. Meany was a member of the War Labor Board, and in 1957, he was nominated by President Eisenhower to be a United States Delegate to the United Nations General Assembly. Mr. Meany holds honorary degrees from De Paul, Pennsylvania, Catholic, Long Island, and Seton Hall Universities.

A PHYSICIAN makes a diagnosis before he prescribes medicine or surgery for an illness. As a practical trade unionist, I think it is essential to examine the issue of inflation before possible solutions are offered. This is particularly true because I believe that this subject has been misrepresented, with consequences that are harmful to our national interests.

Inflation is a condition of sharp price rises associated with too much money chasing after too few goods. The United States has had experience with inflation in connection with wars. Such a situation of excessive demands pressing against shortages of goods, labor, and machines has not existed during the past eight years. However, increasing propaganda about runaway inflation has continued.

A nationwide campaign has characterized runaway inflation as America's major problem. The propaganda campaign has thereby distorted reality. It has submerged the crucial problems facing the nation: namely, national defense in a cold war, public service needs of a growing population, economic aid for the uncommitted peoples of vast regions of the world emerging from colonial domination, and adjustments to automation and rapid technological change.

This campaign has had even more serious results. The Administration and to an extent the Congress have joined this campaign by pursuing restrictive economic measures to curtail demand at a time when both manpower and machines have been idle. These policies have contributed to two recessions in the past six years with the resultant effect of slowing down economic progress. The pace of economic growth in the United States since 1953 has been slower than in almost every other industrial nation and merely one-third to one-half the rate of economic advance in the Soviet Union. The slowing down

in the pace of expanding production and income has contributed to government deficits. Americans have been told, however, that the nation cannot afford increased expenditures for defense and public services because further deficit spending will bring on inflation.

It is time to call a halt to this vicious cycle that has been choking economic progress and has been blocking advances that are needed if America is to remain a vital center for freedom in the world of the middle of the twentieth century. Tough problems in the real world have to be faced and solved.

THREE YEARS OF POSTWAR INFLATION

In the thirteen years since the end of World War II, there have been three years of actual inflationary pressures. Immediately after the end of World War II, excessive demand pressed against a shortage of goods and machines. The pent-up demand of consumers and businesses for all types of goods and the early end of government controls shot prices upward. Between January 1946 and January 1948, consumer prices rose 30 per cent.

The expansion of the economy's ability to produce goods and services brought an easing of inflationary pressures. For two and one-half years, from the start of 1948 to mid-1950, there was reasonable price stability. Consumer prices moved up one-half of one per cent in that period.

The outbreak of the Korean conflict brought another wave of sharply rising consumer and business demands pressing against the supply of goods, labor, and machines. From mid-1950 to early 1951, there was excessive speculation and inventory building by business and hoarding by consumers. In the year between mid-1950 and mid-1951, consumer prices increased almost 9 per cent.

Approximately three-quarters of the

entire postwar rise of consumer prices occurred in those three years of inflationary pressures—1946, 1947, and mid-1950 to mid-1951. Restrictive economic policies may be properly used to curb such inflationary pressures. It is well to remember, however, that “tight money,” high interest rates, and federal budget surpluses tend to curtail demand and slow down economic expansion. If such policies are pursued when there are idle machines and manpower, they result in economic slack and unemployment.

THE CAMPAIGN AGAINST EXPANSION

For four years, from the middle of 1951 to the middle of 1955, there was reasonable price stability. Wages and salaries rose, the economy expanded at a fair pace and consumer prices went up about eight-tenths of one per cent a year. Those four years were not ideal, but they indicate clearly that it is possible to have economic expansion, wage and salary increases, and reasonable price stability at the same time.

During those four years of reasonable price stability, however, many political and business leaders began a continuing propaganda campaign against inflation—“the nation’s number one problem.” The government joined this campaign in early 1953, with restrictive economic policies designed to reduce the pace of economic progress and increase unemployment. These policies contributed to bringing on the recession that started in the summer of 1953.

The campaign to curtail economic expansion paused temporarily for several months, while economic activities declined, but it was resumed again when production and employment rose. Restrictive economic policies cut short the recovery from the recession. The number of unemployed was an average of

2,860,000 in 1955 and 1956, compared with 1,970,000 in 1951–53.

Despite restrictive policies and the persistence of slack in the economy, prices began to creep upwards. During the three years from mid-1955 to mid-1958, consumer prices rose about $2\frac{1}{2}$ per cent a year. Although there was no excessive demand and there were no general shortages, these creeping price increases were termed inflation. The propaganda campaign against runaway inflation was stepped up. The newspapers, radio, and television were filled with fear-inciting declarations on inflation and justifications for economic policies that became increasingly restrictive.

Under the impact of these policies, economic expansion slowed down in 1956 and almost ground to a halt in the first half of 1957. Nevertheless, the money supply was further tightened in August 1957, at about the same time as the start of the recession. As unemployment soared to more than five million, the campaign against runaway inflation was relaxed again, only to be resumed in the summer of 1958, as soon as an economic improvement was under way. Prices, however, leveled off, and the consumer price index was reasonably stable from mid-1958 to mid-1959.

THE PRICE LEVEL IN PERSPECTIVE

The facts reveal a problem in terms of prices, but not a problem of excessive demand and general shortages. In the eight years from mid-1951 to mid-1959, consumer prices increased by an average of less than $1\frac{1}{2}$ per cent a year. The real problem, therefore, has not been runaway inflation, but rather a slowly, upward creeping price level.

“Tight money” and other restrictive economic policies may make sense in reducing excess demand during an inflationary situation. They have not

stopped the slow, upward creep of the price level. However, such policies have achieved their purpose of reducing the pace of economic growth and increasing unemployment.

A Harvard professor, Alvin Hansen, has tried to put into some perspective the slow, creeping price rise of recent years. Professor Hansen has pointed out that in the entire 1948-58 decade, which includes the Korean inflation, the average yearly rise of consumer prices was $1\frac{3}{4}$ per cent. Professor Hansen states

In contrast, in the sixteen years of peacetime prosperity from 1897 to 1913, the compound rate of increase was much higher— $2\frac{1}{2}$ per cent. Taking the longer view covering the six decades from 1897 to 1958, the per annum rate of increase of prices (wholesale and consumer) was $2\frac{1}{8}$ per cent . . . the record during the years 1948-58 (which, however, included a war of considerable dimensions) discloses a per annum price increase not much more than half as large as that of the entire sixty-year period. This is by no means an irresponsible period.¹

This is not to condone or to be pleased with price increases. It is only an attempt to place the price rises we have had in proper perspective. The record of the past decade has been exaggerated by a propaganda campaign that seeks support for "tight money," slower rates of economic expansion, higher levels of unemployment, and attacks on organized labor and collective bargaining.

THE ATTACK ON ORGANIZED LABOR

The campaign against economic expansion has been directed particularly against organized labor and collective bargaining. The newspapers, radio, and television have been full of this daily attack for several years. Americans

have been told incessantly that wage increases are an inflationary evil, since they are supposed to have resulted in both excessive consumer demand for goods and great increases in costs per unit of production.

There was no excessive consumer demand, however, from mid-1955 to mid-1958, when prices were creeping up. There were no general shortages of goods. Instead, there was weakness in consumer markets during most of that time and there was a growing gap between the economy's ability to produce and its ability to consume. What was needed in that period was more consumer demand, not less of it.

As for unit costs, the propagandists who have fought so hard for restrictive policies fail to reveal the facts. Rising output per manhour of work tends to offset the cost increases of improvements in wages and fringe benefits. Since 1947 output per manhour of work has risen at a faster rate than in previous periods, despite the slow pace of economic progress in the past few years.

In manufacturing, where unions have been subjected to a continuing attack, payroll and fringe benefit costs of factory production and maintenance workers per unit of output were no greater in 1958 and the first half of 1959 than they had been in 1953. Can these relatively stable unit costs of factory production and maintenance workers possibly be the cause of creeping price rises?

It is the attack on trade unions and collective bargaining that exposes the underlying drive of the campaign for restrictive economic policies. The entire campaign is basically a fight against economic expansion and full employment. The attack against trade unions, as well as the propaganda for "tight money" and budget surpluses at low levels of output and income, is an attempt to achieve a slow pace of eco-

¹ Letter in *New York Times*, January 23, 1959.

economic progress and high levels of unemployment. What the restrictionists have not yet fully developed is a formula by which they can attain sufficiently high levels of unemployment to satisfy them and win elections at the same time.

WAGE INCREASES ARE REQUIRED FOR EXPANSION

Steadily increasing real wages and salaries are a basic necessity for economic progress. They are the foundation for expanding consumer markets. It is largely on the basis of growing mass consumer markets that America's industries and productivity have been built.

About two-thirds of all the goods and services produced in the United States are bought by consumers, the economy's largest market. An additional 4 per cent of the nation's total output goes for home building which is largely based on the state of family buying power and availability of credit for customers. The sale of approximately 70 per cent of national output depends on the incomes of consumers and their desire to buy the goods and services that can be produced. If the economy is to grow, consumer mass markets and family incomes must increase, or industry's improving ability to produce a rising volume of goods and services will be to no avail.

Consumer markets also are the base for business decisions to invest in new plants and machines. Rising family incomes, growing consumer markets and expectations of increasing consumer sales—these are the basic incentives for businessmen to increase their investments in new and more efficient productive capacity.

Growing mass markets have been one of the secrets of the American economy's success. For decades, Americans were proud of high and rising real wages

and salaries, low unit profit margins, and continuing improvements in living standards. Foreign experts came to study America's economy where working people shared in the fruits of progress. Other countries were urged to adapt American emphasis on expansion and consumer markets to their own societies.

Now, however, the present campaign tells the American people that such achievements are to be considered evil, that restrictive policies provide little economic progress, and that there is very little room for improvements in wages and salaries. At the very time when European countries are beginning to move in the direction of America's pattern of economic success, the United States is moving in the opposite direction, towards economic stagnation.

GREAT COST OF RESTRICTIVE POLICIES

The campaign against inflation and the restrictive economic policies that go along with it have cost the nation dearly. The pace of economic growth has been cut in half, and crucial national needs have been neglected. The volume of real national output, which rose by a yearly average of 4.7 per cent in 1947-53, has slowed down to an average yearly rate of 2.4 per cent in 1953-59. Since the population has continued to grow by about 1.7 per cent a year, real national output per man, woman, and child has increased at a snail's pace in the past six years.

This slow pace of economic expansion has produced a trend toward relative economic and military weakness in relation to the Soviet Union, although the Soviet's total output is merely about half as great as America's. The totalitarian system siphons off a large share of production for military and cold war purposes. In recent years, total production in the Soviet Union has been increasing two to three times faster than

in the United States—permitting rising outlays for military and cold war purposes and some small increases in consumer goods. The slow growth of national output in the United States and the government's overriding emphasis on balancing the budget at all costs have placed severe limits on defense and foreign aid expenditures. At the same time, the increasing needs of America's growing population for such public services as education, health, housing, urban redevelopment, and community facilities have been neglected.

The number of jobless has risen from 3 per cent of the labor force in 1951-53 to an average of about 5 per cent in 1953-59. In addition, the economy's failure to provide a sufficient number of new jobs has aggravated the difficulties of hundreds of thousands of workers who have been displaced by technological change in manufacturing, mining, and railroads.

The restrictive policies that were supposed to curb price increases have contributed to pushing up the price level. As a result of the economy's slow growth, the costs of new machines and technological improvements have been spread over a slowly rising number of units of output—pushing up unit costs and applying an upward pressure on prices. More rapid economic growth would stabilize unit costs.

The slowing down in economic expansion has been largely responsible for federal budget deficits in the fiscal years ending June 1954, 1955, 1958 and 1959. These deficits were, in large measure, the results of recessions and declines in output and income. A higher rate of economic expansion would have produced greater incomes and increased federal revenue.

Increasing propaganda about runaway inflation has had an effect on upper-income families, convincing many of them to invest their savings in stocks

rather than in long-term government bonds. This has contributed in great part to the government's financial difficulties.

FIRST THINGS FIRST

The crucial task, in terms of economic policy, is to put first things first on the basis of reality, regardless of how unpleasant reality may appear. Indeed, the longer America continues to tilt with windmills of inflation, the more unpleasant the reality will probably become.

There are major problems to be faced in the areas of national defense and economic and technical aid to the uncommitted peoples of less-developed regions of the world. To move forward to meet these needs requires increased government expenditures that can be financed with the government revenue derived from a faster pace of economic growth.

There are likewise enormous problems to be met in increasing the public service needs of a growing population. According to government estimates, by 1965, there will be 54 million more Americans than there were in 1945. Public services neglected during the depression and war years have been inadequately met since the war's end. A dent has hardly been made in the great backlog. Little if anything has been done to meet the needs of our growing population. These needs can and should be met by comprehensive government programs that can be financed by increasing government revenue that would be collected from rising incomes associated with a rapid rate of economic growth.

Hundreds of thousands of workers, thousands of businesses, and scores of communities are economically distressed because of technological change. Industries have shut down or moved to new locations. The spread of automation and rapid technological change threaten to increase the seriousness of this prob-

lem, even if most of the nation is prosperous. Federal government aid is long overdue for the retraining of displaced workers in new skills, attempts to attract new industries into distressed communities, and assistance for businesses in such communities to adjust to new products and markets.

Extension of coverage under the Fair Labor Standards Act to millions of low-paid workers and an increase in the federal minimum wage from \$1.00 to \$1.25 an hour, would be of great help in eliminating poverty in America. Great housing shortages continue to persist as older homes are not replaced and our population grows and the rate of family formations increases. Slum areas and deterioration of the central core of our great cities require that urban renewal and development programs be vigorously pursued. Dilapidated condemned structures that house our school children need to be replaced, to say nothing of the need to construct even more new schools to take care of the growing number of school age children. Hospitals and health facilities are greatly in need of being increased. These are just some of the nation's major problems that require immediate action. They should be given top priority in any meaningful economic policy.

ECONOMIC EXPANSION OF 5 PER CENT A YEAR IS ESSENTIAL

After examining America's vast needs and great economic potential, a recent report by the Rockefeller Brothers' Fund stated that,

a growth rate of 5% is possible if we realize fully our impressive opportunities for economic expansion We can afford the defense program essential for survival. In doing so, however, unless we achieve a 5% growth rate, we shall have to hold back otherwise desirable expenditures in the government field and keep the

growth of private expenditures below a level commensurate with our aspirations.²

Rising national productivity of about 3½ per cent to 4 per cent a year and annual increases in the labor force of 1½ per cent make economic expansion of 5 per cent a year both possible and necessary. Indeed, if the economy fails to expand by 5 per cent a year to create enough new job opportunities, rising productivity and a growing labor force will mean increasing unemployment.

Economic expansion of 5 per cent a year, therefore, should be the central point of national economic policy—to enable the nation to meet its major needs and to sustain full employment. Rising national output of 5 per cent a year would also minimize the kind of increases in unit costs of recent years that applied upward pressures on the price level.

STEPS TO CURB PRICE RISES

Since actual inflationary pressures of excessive demands and general shortages are related to wars, it seems to be a matter of common sense that the government should be armed with comprehensive, standby economic stabilization legislation to be used if war breaks out. Such legislation should include comprehensive controls over the commodity exchanges and bank credit for business and consumers as well as price and wage stabilization to be imposed in the event of war. It took seven months of sharply rising prices after the Korean conflict began before Congress enacted stabilization legislation and administrative machinery was set up.

If one remembers that more than three fourths of the price rises in the post-World War II period occurred in the three years 1946-48 and 1950-51, then the need for comprehensive standby legislation to curb inflationary pressures

² *The Challenge to America* (New York: Doubleday and Company, 1958), p. 73.

associated with war or the aftermath of war is essential.

The actual problem of a slowly, upward creeping price level in peacetime such as we had from mid-1955 to mid-1958 requires careful study and analysis rather than restrictive policies and antilabor prejudice. A more rapid pace of economic growth would minimize some of the pressures that produced an upward creeping price level in these years. A faster pace of economic progress would also provide a healthier environment for sober examination of the problem and development of possible solutions.

During the period from mid-1955 to mid-1958, the major pressures were from the prices of food and services. In both these areas, important factors in the price increases were population growth and suburban living. Food prices were affected by crop conditions as well as shifts in consumer tastes

towards packaged and frozen foods. Prices of services were pressed upward by increasing demand for better housing, health care, professional services, finance and insurance charges, and other types of services.

Each part of the economy should be examined for the possible development of greater efficiency and lower profit margins. The focus of public attention should be placed on the cost-price-profit-investment policies of the dominant corporations in key industries, whose prices are administered rather than set by competition.

The Congressional Joint Economic Committee and the Subcommittee on Anti-Trust and Monopoly of the Senate Judiciary Committee have begun parts of such careful studies. A comprehensive effort is required, however, to devise specific suggestions to curb the varying types of slowly rising prices in peacetime.

The Fight Against Inflation in Canada

By HARVEY PERRY

ABSTRACT: Canadian postwar experience with inflation has closely paralleled the American with the exception that its federal government budget has been balanced for most of the period, capital expenditure has been a higher proportion of gross national product, and foreign investment in Canada has been extremely heavy. Recent attitudes towards inflation reflect an intense reaction on the part of investors towards government financial measures and a concern that returning prosperity will produce price rises. Lessons of Canadian experience raise some serious questions as to the efficacy of fiscal and monetary policy.

*Harvey Perry, Toronto, Canada, is Director and Chief Executive Officer of the Canadian Tax Foundation. He was with the Department of Finance, Ottawa, for sixteen years. In 1952 Mr. Perry was appointed Director of Research of the Canadian Tax Foundation and in 1954 became Director and Chief Executive Officer. In May and June 1953, he was engaged on special assignment for the Colonial Office in Nigeria, West Africa, and in January and February 1958 visited Ghana on a mission for the United Nations. At present he is making a survey of the budgeting system of the Province of Newfoundland. Mr. Perry is a frequent contributor to tax and other periodicals. He is the author of *Taxation in Canada* (1951) and of *Taxes, Tariffs and Subsidies, a history of Canadian fiscal development* (1955) and co-author of *Financing Canadian Federation* (1953).*

CANADA shares the common experience of the Western world that in the past year inflation has been an issue of general public concern. Economists have propounded their views on its causes and remedies; financial and governmental authorities have dilated on its dread consequences; labor leaders have risen to challenge allegations of the pregnant role of wage increases in the inflationary process; and the public at large has shown an aroused consciousness of the issues involved. The final episode, just concluded as this article is being prepared, was an enquiry, with public hearings, on inflation by the Finance Committee of the Canadian Senate. Such hearings are rare in Canada, and the parade of witnesses who presented briefs on behalf of nearly every major economic group in Canada reflected current intense interest.

The most remarkable aspect of all this activity is that it has taken place in the face of substantial unemployment and virtual stability in prices; agreement is almost unanimous that there is no inflationary movement at present and that the risks are almost entirely latent. Despite this background just as in the United States a strong "psychology of inflation," amounting almost to a phobia, has taken root. Influential elements in the financial and business community appear to have lost confidence in the future stability of the currency, and this fear has been reflected in strong expressions of alarm, which in turn have further undermined general public confidence. It will be the purpose of the present article to present briefly some of the particular aspects of Canadian experience which have led to the present position.

PAST PRICE RISES

It goes without saying that the first cause of concern with inflation is that

it has happened before. Canada, despite its record for extreme conservatism in fiscal and monetary policy in the postwar period, has been through at least three bouts of steep price rises. The aggregate rise in the Consumers Price Index between 1946 and 1958 was 47.5 per cent, an annual rate of $3\frac{5}{8}$ per cent compounded. The first and sharpest rise was during the consumer buying boom of 1946 to 1948; the second came with the Korean conflict and rearmament in 1950 and 1951, and the third arose from an investment boom in 1955 to 1957.

Each of these rises has been less acute than the previous and would have been more severe had not fiscal and monetary policy been employed as a countermeasure. In the immediate postwar period the federal government maintained taxation sufficiently heavy to produce substantial budgetary surpluses. During the Korean episode and the rearmament step-up, fiscal policy was again relied on almost entirely as a countermeasure. Strong public pressure for a price ceiling and an excess profits tax was resisted. In their place general increases in levels of existing taxation were enacted almost sufficient to offset the new expenditures. The unusual step was also taken of deferring depreciation under the tax laws on certain kinds of investment expenditures incurred during a fixed period. Monetary policy took the form largely of suasion exerted by the Bank of Canada on the chartered banks to maintain a ceiling on their loans.

As contrasted with the earlier strong emphasis on fiscal policy, during the "investment boom" of 1955-57 monetary influence was the predominant factor of restraint. The chartered banks, again under suasion, increased their liquidity ratios and ceased long-term loans for new capital investment, then a new and rapidly developing feature

of Canadian banking. After a decade at relatively low levels, interest rates began a climb in 1955 which has continued ever since. In the 1955-57 period tax rates remained relatively stable, but were kept sufficiently high that surpluses continued to emerge in the federal budget.

SUSTAINED INFLATIONARY PRESSURES

In addition to the special factors which accentuated price rises during these three periods, the postwar years have brought sustained pressure as the result of the dynamic growth of the Canadian economy. The rate of population increase has been unprecedented; amounting to over one-third in the 1946 to 1958 period. During the same period gross national product rose by 134 per cent; even deflated by approximately one-half to allow for price increases, this is still a rate of growth paralleled in few other countries. The most unusual feature about the period however was the continuously high level of capital expenditure. On average, 23 per cent of gross national product was accounted for by such expenditure, as compared with a corresponding ratio of perhaps 12 to 15 per cent in the United States. A substantial part of the private segment of this expenditure was financed by an inflow of capital from abroad. This massive inflow has added to the inflationary pressure and has created additional problems by maintaining the Canadian dollar at a premium of 3 to 5 per cent over United States funds for the last several years. Other long term sustaining factors have been the introduction by the federal government of income maintenance programs, such as family allowances and universal old age pensions at age 70, and a general rise in government expenditures at all levels. In recent years in particular the capital expenditures of provincial and municipal governments have been growing

rapidly to meet the demands of the increased population and heightened economic activity.

To an American audience most of this record of recent developments will sound familiar. Canadian economic movements follow very closely those of the United States, and it is only in minor respects that divergencies appear. In the present context the differences that are most relevant are: the maintenance almost throughout the postwar period of a surplus in the Canadian federal budget; the higher proportion of the gross national product devoted to capital investment in Canada; and the marked concentration of economic growth in the postwar decade.

THE PRESENT POSITION

Against the background of this admittedly brief summary of the postwar decade in Canada, it is possible now to review the immediate situation in perspective.

The recent period can be taken as roughly the two years from mid-1957 to mid-1959, or in general the period of the Canadian recession. Data related to 1958 will serve to give its main characteristics, although conditions are beginning to change in 1959. There was relative stability of consumer prices by previous standards (2.6 per cent increase); relatively high unemployment (a peak postwar rate of 6.6 per cent of the labor force in 1958); a sharply diminished rate of growth in gross national product (2½ per cent in 1958 over 1957 as compared with the average annual growth of 8.7 per cent for the eleven years 1946 to 1958) and a decline in capital expenditures (about 3 per cent).

Obviously none of these are portents of inflation—rather the reverse. In 1959 underlying trends are showing an upturn, with an increase in gross national product of 7 per cent anticipated and

capital expenditure on a slightly higher scale than in 1958. Unemployment is also at a rate lower than a year ago. But a price increase of even lesser proportions than in 1958 is forecast and excess capacity in many industries gives substance to this prediction. These basic indicia therefore still give little ground for anticipation of an immediate inflationary movement.

In this light the psychological overtones of the current fears are probably more relevant than statistics—and certainly are much more difficult to assess. As far as the present writer has been able to determine, and there are many other views that could be advanced, in the present juncture the most productive subject for analysis is the investor; he is not alone in his concern with inflation, but current fears seem to be dominated by the reactions of the financial markets and the persons and institutions which guide those markets. As indicated by recent relationships between prices of equities and government bonds, the investor is so concerned with future loss of capital values that he shuns first-grade bonds with an unprecedented yield for the inflationary hedge of shares, even at a low annual return.

Again Canadian experience is not unique in this respect, but there are some special circumstances which go a long way in accounting for the particularly sensitive attitude of the Canadian investor in the recent past. They are:

1. The emergence in 1958 of the first substantial postwar deficit in the federal budget. This was a sharp reversal of the long series of surpluses, some of them very substantial, that had prevailed for over a decade. In total it amounted to about 650 million dollars, or some 15 per cent of expenditures. It came about as the result in part of the economic downturn, which reduced revenues, and in part as the result of increased expenditures attributable to

the implementation by a new government of its election promises. That these promises involved a further extension of the welfare state through the introduction of a national hospital insurance plan and an increase in the amount of the old age security pension did not add to their luster in the eyes of conservative business and financial elements. On economic grounds a deficit was justified for 1958; but its origin was disturbing.

2. The fact that in addition to the financing of its first large postwar deficit in 1958 the federal government required almost as much again in new cash for other purposes (housing, etc.) in that year. Total net cash requirements, including the financing of the deficit, amounted to $1\frac{1}{4}$ billion dollars. This is a comparatively large amount of financing for the Canadian market, and its psychological impact was all the greater because for a long period previous federal borrowing had not exceeded 200 million dollars in any year. The market was therefore unprepared to absorb in one year new financing of this magnitude.

3. To add further to the strain on the market, the federal government chose 1958 as well as the year in which to refund about one-half its existing debt to a longer term. This operation took place in the summer and fall of 1958 and was known as the Conversion Loan. Its success was felt to be sufficiently important to warrant increasing the rate of interest on the debt involved from about 4 per cent to $4\frac{1}{2}$ per cent. Almost immediately after the operation was completed—in the fall of 1958—in common with the United States experience, government bond prices began to drop and have been falling almost continuously since.

Finally, to ease the new financing requirements and the Conversion Loan operation, the central bank increased

the money supply during the course of 1958 by about 1 billion dollars. This was felt by many to pose a threat for the future and contributed to the general unsettlement of the financial community.

In retrospect it can be seen that in 1958 the Canadian financial and money markets were badly shaken by a conjunction of unusual circumstances. The sharpest indication of the continuing apprehensive frame of mind has been the rate on 90-day government treasury bills. Five years ago this rate was below 1 per cent; now it ranges between 5 and 6 per cent. This abnormal exaction for lending short-term money to governments seems to focus the current attitude of the business and financial community. The flight into equities, which by raising prices has reduced yields on first-grade Canadian stocks to about one-half the yields of government bonds, is also evidence on classical lines of a fear of inflation, in which concern for the stability of the national budget seems to have played an important role in Canada.

Apprehension regarding the national budget has now outlived its time. Tax increases announced by the Minister of Finance in his Budget Speech of last April, along with a rapid recovery in revenues with climbing business activity, will probably close the deficit gap in the next twelve months. This should have satisfied the many voices that called for a return to a balanced budget, but none of the usual signs suggest that confidence has been restored. On the monetary front the Bank of Canada has resolutely resisted any temptation to increase the money supply, which has remained at almost the same level since last October. This should in turn have satisfied those who expressed grave concern over the possibility of a further injection of new cash into the banking system but seems to have had no such

result. In fact, there are now stray voices suggesting that perhaps the Bank is going a little too far and that with an upturn in business activity the economy requires more cash. If not the spoken prayer then this must at least be the silent one of most chartered bank presidents, whose institutions are now selling off bonds at much below cost in order to obtain cash for the rapid expansion in business loans that has marked the first half of the year.

What inflationary dangers may arise in the next phase of the Canadian economy it is difficult to say as yet. There is still uncertainty as to how much momentum lies behind the current upturn, since it is not as buoyant as the American. The view of some economists is that Canada may not have a recurrence of the rapid upsurge of the past decade, and if this expectation is realized the problems will be correspondingly diminished. However, it would be naive to assume that inflation will give no further trouble in Canada; on the contrary even a continued expansion at a slackened pace will keep pressure on the economy. It is therefore relevant to see what lessons if any can be derived for the future from the experience of the last decade.

FISCAL POLICY

In view of the active adherence of the Canadian federal government to the dictates of contracyclical budgeting, as manifested by a long series of surpluses in the postwar period, it is ironical that fiscal policy in the final analysis turned out to be an Achilles' heel. The public at large seemed to accept with very little question the concept of reducing debt in good times, but when the budget was allowed to go into deficit the result was a major loss of public confidence in the federal financial authorities. This aspect of deficit financing had hardly been anticipated, and it leaves many

questions regarding psychological implications which might have been expected but did not arise during the earlier period of surplus financing. This outcome is fortunate for the cause of anti-inflationary fiscal policy, but leaves the other half of the cycle in question.

Another equally important limitation of fiscal policy lies in its inability to distinguish among causes. Nearly every tax measure that ingenuity could devise has been employed in Canada in recent years, and all have been found blunt and unwieldy to the point that few federal tax authorities today have much faith in the efficacy of special devices. The fact that none has been employed in recent years is the best evidence of this. Fiscal policy is equally ineffectual for influencing individual regions or industries. A general tax raise may be indicated as the right medicine for the economy as a whole, but may be poison for struggling industries or lagging areas.

MONETARY POLICY

Almost the same deficiencies have been found to arise under monetary policy in practice. Lack of selectivity in over-all ceilings on bank loans means that small businesses, the municipalities, and the weaker provincial governments bear the heaviest burden of the restriction. Tight money policies and high interest rates have presented a dilemma to borrowers with good credit ratings but little authority in the market. Among these the Canadian municipalities, to which capital funds could be diverted with great advantage to the over-all economy, are the most conspicuous instance. What is even more striking in the last decade is the insularity of wealthy and well-established corporations from general measures of credit restriction. Internally generated funds now seem to have given many large business organizations virtual im-

munity from credit controls. Ironically it is the combination of relatively high rates of write-off for fixed assets and relatively high levels of corporate taxation that has fostered this position.

A feature of monetary policy in Canada that constantly puts the central bank on the horns of a dilemma is the effect of high interest rates in attracting international investment funds to this country. The enhanced flow that always follows an interest rise adds to the pressure on the Canadian dollar and by increasing its premium further worsens the position of the exporting industries in relation to the rest of the economy. A high Canadian interest rate also stimulates borrowing in New York, with a resulting further pressure on the Canadian dollar. Frequently a great part of the weight of a tight money policy falls on Canadian exporters through the indirect route of exchange appreciation, a result which is rightly regarded as being as inequitable and capricious as the effects of inflation itself.

Monetary policy, unlike fiscal, is still executed in Canada by an independent central bank. Increasing discussion of all its aspects in Parliament, however, gives rise to a question as to whether it will be possible to maintain the position in the future that monetary issues are outside the purview of the federal government. The Minister of Finance frequently finds himself in a perplexed and unhappy position under the present arrangements.

THE FUTURE ALTERNATIVES

All of this is perhaps no more than to say that the instruments of control have been found to be imperfect in many respects. To improve their operation would require making them more selective, and each step in this direction means moving farther away from the basic ideal of setting the climate in which market forces may oper-

ate with relative freedom. The only feasible alternative is that urged in its report by the Senate Finance Committee—general public understanding and appreciation of the basic issues involved in the inflationary process. This may be a counsel of perfection when addressed to union leaders, company executives, and politicians, each of whom can easily persuade himself that his individual actions will have only slight

influence on the economy as a whole. It also assumes that there are some basic truths about inflation that have been graven in economic stone and handed down as final precepts, an illusion quickly dispelled by a review of any current economic journal. Perhaps in the end the greatest need is for economists to agree on a clear statement of the issues involved in terms that the public can accept.

Should We Accept Inflation?

By CARROL M. SHANKS

ABSTRACT: Under conditions existing in the American economy today, there are periods when it is extremely difficult to achieve simultaneously the two major goals of high employment and stable prices. Abandonment of the goal of price stability is not an acceptable solution to this problem—first, because reasonable price stability is essential to a just distribution of output, and second, because it would be even more difficult to maintain high employment under a conscious national policy of inflation than under a policy directed toward stable prices. Under every assumed rate of inflation, the monetary and fiscal authorities would again be faced with exactly the same dilemma. The goal of stable prices would have been sacrificed only to find that nothing had been gained with respect to employment and output. As in the case of most dilemmas, the solution is found by restating the problem: it is not stable prices and high employment which are incompatible; it is unrestrained monopoly power and high employment which are incompatible. The acceptance of inflation will not solve the problem. High employment and an equitable distribution of output can be maintained only by taking steps to restrain monopoly power, wherever it may exist in the economy.

Carrol M. Shanks, Newark, New Jersey, is President of The Prudential Insurance Company of America. Before joining the Prudential in 1932, Mr. Shanks practiced law in New York, was Associate Professor of Law at Yale Law School, and lectured at Columbia Law School. He is co-author, with William O. Douglas, of several textbooks on corporation and business law. Mr. Shanks is a trustee of Rutgers University, Johns Hopkins University, Wheaton College, and the Institute for Advanced Study at Princeton, New Jersey. He is a Director of Morgan Guaranty Trust Company, Public Service Electric and Gas Company, Bigelow Sanford Carpet Company, Inc., Fidelity Union Trust Company, National Biscuit Company, Union Carbide Corporation, and Georgia-Pacific Corporation. Mr. Shanks is a Director and past president of the Life Insurance Association of America.

THE two most widely recognized objectives of economic policy in the United States today are a high level of employment and a stable level of prices. During the postwar period, we have succeeded with respect to one of these goals, but we have fallen down rather badly with respect to the other. Except for brief recessions in 1949, 1954, and 1958, employment has been maintained at a very high level, and real output has advanced at a rapid rate. We have not succeeded, however, in maintaining reasonable stability of prices. From the end of 1945 to the beginning of 1952, consumer prices rose by 6.4 per cent per year, and a further increase of 8 per cent took place from the beginning of 1956 to the middle of 1958. The cost of living today is 60 per cent higher than at the end of World War II.

Our success in achieving high employment and our failure to achieve stable prices have led to a widespread and growing fear that inflation is inevitable. This fear has had its sophisticated counterpart in the thesis that, because of structural rigidities in the American economy, stable prices and high employment are incompatible. If we want high employment, so it is held, we must accept inflation. Price stability can be secured, it is argued, only at the cost of a large amount of unemployment, and because price stability is after all a relatively unimportant objective it should be sacrificed to the more important goal of high employment.

The basic questions which the above thesis raises are these: Is it true that high employment and stable prices are incompatible? Is the goal of stable prices relatively unimportant so that it could be sacrificed without serious harm to the economy? Would abandonment of the goal of stable prices solve the problem? Would it be easier

to maintain high employment under a national policy which publicly accepts inflation than under one designed to achieve stable prices? Is it stable prices and the steps necessary to maintain them which conflict with the goal of high employment, or is there a more basic problem? What public policy steps need to be taken to improve our ability to maintain high employment, as well as to achieve our other basic economic goals?

ARE HIGH EMPLOYMENT AND STABLE PRICES INCOMPATIBLE?

During any period of high employment there is likely to be upward pressure on prices simply because high employment generates high incomes, and these incomes in turn lead to increased consumer purchases. Business expenditures for inventory and for plant and equipment are also likely to be high, so that still more employment is created and there is a further swelling of incomes. Total money demand tends to rise in cumulative fashion and eventually reaches the point where the economy cannot turn out goods and services fast enough to meet this demand.

With employment high and businessmen bidding for their services, workers are likely to seize the opportunity to secure large wage increases; this increase in the cost of production is likely to result in many cases in a rise in the price of the product. The fact that total money demand exceeds the capacity of the economy to turn out goods and services is thus likely to provide the setting for a rise in the general level of prices, or inflation.

In such a situation, a good deal of the pressure for price rises can be relieved by appropriate monetary and fiscal policy. If government expenditures are reduced, a portion of the excess money demand will be removed, and if Federal Reserve policy is restrictive, it

will be more difficult to secure loans to finance consumer and business purchases. Appropriate monetary and fiscal policy might thus hold total money demand to the level which would be just sufficient to purchase the total output of the economy at high employment of labor and plant, and at a stable level of prices.

Suppose, however, that in this finely balanced situation strong labor unions continue to push for large wage increases in excess of improvements in productivity. Inasmuch as times are good, businessmen may not resist effectively these excessive wage demands but may pass them along to the consumer in the form of higher prices. Rising prices will then lead to the adoption of a more restrictive monetary and fiscal policy, which will further curb total money demand. The combination of rising prices and restricted demand will result inevitably in a reduction in the real volume of goods and services sold, which after a while will result in cut-backs in production and the appearance of some unemployment. If labor continues to push for large wage increases, the resulting steady upward movement of prices will force an even more restrictive monetary and fiscal policy which will further reduce real output and employment. Under the assumed conditions, the attempt by the monetary and fiscal authorities to achieve stable prices will succeed only in reducing output and employment.

The illustration above is cast in somewhat extreme terms, but it is nevertheless a sufficiently accurate picture of the workings of the American economy during boom periods as to suggest a real dilemma for monetary and fiscal policy. Where wages and prices can be forced upward in the face of a stable level of final demand, there will inevitably be periods when it is extremely difficult, and perhaps impossible, to achieve

both price stability and high employment. It is this dilemma which has led some observers to suggest that the goal of price stability be abandoned, and monetary and fiscal policy be adapted to whatever degree of price rise seems necessary in an attempt to maintain high employment.

Before jumping to this seemingly easy solution, it may be well to ask the following two questions: Is the objective of price stability unimportant, so that it can be abandoned with no serious injury to the economy? If price stability were abandoned, would it solve the dilemma described above?

IS REASONABLE STABILITY OF PRICES IMPORTANT?

I believe that the avoidance of inflation is not only an important, but an essential, objective of national policy.

All of us are prone to discuss inflation as though it were a peculiarly financial phenomenon involving mysterious forces such as the quantity of money, foreign exchange rates, fiscal policy, monetary policy, or the price of gold. In the real world, however, prices are not determined by the quantity of money; they are determined by people. The process of inflation does not consist of the numbers appearing in the consumers' price index; the real process of inflation occurs when the seller of a good or service unduly enriches himself at the expense of the buyer. Except in the unlikely situation where all prices and all wages and other incomes rise in exactly the same proportion, inflation means that the standard of living of some groups is being raised by depressing the standard of living of other groups. By its very nature, the inflation process indicates that some individuals or groups in the economy are gaining and others are losing.

Who is it who gains, and who loses, through inflation? Inflation is the

means by which a small but tightly monopolized segment of the economy appropriates real goods and services from the great majority of the public. Some of the losers in the inflation struggle are easily identified. The retired, families living on the proceeds of savings, the disabled, the unemployed, and the very large group of workers whose dollar incomes remain relatively constant over many years—all these obviously suffer a decline in their real standard of living through inflation.

But these are not by any means the only groups whose welfare is sacrificed when we surrender to inflation. The losers include a good portion of organized, as well as unorganized, labor. When, for instance, a strong labor union secures a wage increase large enough to force an increase in the price of the product, or a corporation pushes through a price increase not necessitated by rising costs, the members of this union, or the owners of the corporation as the case may be, take real purchasing power away from all buyers of this product, including the rest of organized labor. The inflation process is thus a means by which strong labor unions and other highly organized groups exact tribute from weak labor unions, as well as from the great majority of the public which is not organized.

There has been insufficient recognition of the fact that the wage-bargaining process is, in its end effects, a struggle between groups of workers, and not between workers and corporations. Because wages are the principal component of costs, the wage-setting process largely determines the price of the product. Wage increases which absorb the full improvement in productivity are the means by which labor in a given industry prevents all other workers, as well as the retired and the unemployed, from sharing in the fruits of advancing technology in that industry. Wage in-

creases in excess of productivity improvements are an out-and-out transfer of real income from the majority of workers to the relatively small group which is able to force an increase in the price of the product. Wage increases in excess of productivity gains are paid for—and in the last analysis can be paid for only—not by capital but by other workers, and those not employed, in the form of higher prices for the goods and services they buy.

A national policy which endorsed inflation would encourage and facilitate the transfer of economic advantage from the great mass of workers to the small group represented by the most tightly organized and most monopolistic elements in the economy. The most pernicious aspect of chronic inflation is not that it frequently leads to maladjustments and recessions, not that it may break away into a wild boom, not that it is beginning to price us out of foreign markets as well as volume domestic markets, not that it encourages speculative as opposed to productive activity. Inflation does all these things, and they are undesirable. But its worst aspect is that it increases the disparity of power and of real income in the economy, and does so in an arbitrary fashion having little relationship to any standard of fairness and justice.

The objective of stable prices must constitute an essential part of national policy if we are to approximate a just distribution of our economic output.

ARE HIGH EMPLOYMENT AND INFLATION INCOMPATIBLE?

Let us suppose for a moment, however, that we are willing to sacrifice the economic welfare of broad groups in the economy, and that we are willing to accept the injustice and the growing disparity in economic power which inflation brings. If we accept these evils and embark on a national policy which

deliberately adjusts monetary and fiscal policy so as to attempt to maintain high employment through a conscious policy of inflation, are we likely under these circumstances to avoid the dilemma discussed earlier in this article? Would it be any easier in practice to maintain high employment with inflation than it is to maintain high employment with stable prices? Might we sacrifice the goal of stable prices only to find that we had gained nothing with respect to employment?

I believe that this question can be answered with a fair degree of certainty. Sacrificing the goal of stable prices would not improve our ability to achieve the goal of high employment. We would, instead, find it more and more difficult to maintain prosperity. The economy would become progressively less stable, the distribution of our output would become progressively more inequitable, and employment and prices would become progressively less amenable to the influence of any government measures short of direct price and wage control and direct allocation of the labor force.

Take the situation discussed earlier in this article in which the economy is operating at capacity, demand is exceeding the output of goods and services at current prices, and the stronger labor unions seize this opportunity to push through wage increases in excess of productivity improvements and thus start prices upward. In order to prevent the price rise from resulting in a reduction of output and employment, an expansionary monetary and fiscal policy would then be adopted in order to raise money demand so as to absorb full output at the new, higher level of prices. What is likely to be the reaction of business and labor to this easy money policy?

The pressure on business to resist inflationary wage demands would be

lessened. The monopoly position of the strongest labor unions would be strengthened because of the high demand for labor, and unions would now have an added incentive, in the form of a rising cost of living, to demand still further wage increases. The fact that productivity would necessarily be increasing only slowly over time would no longer have any bearing on the bargaining process. Inasmuch as wage and price increases of any size are now to be validated by a conscious national policy of expanding money demand, only the foolish or the weak would be satisfied with moderate wage and price increases.

The net result would be that, if it had initially been necessary to permit a 2 per cent annual increase in prices in order to maintain high employment, it would soon be necessary to permit a 3, and then a 4, and then a 5 per cent annual increase in prices. Because there would be no limit to the money wage increases which could be demanded, there would obviously be no limit to the increase in the money supply which would be needed to accommodate the resulting rise in prices. Labor unions could certainly adjust wage demands upward as rapidly as the monetary and fiscal authorities could expand the money supply, so that the government would be faced constantly with the situation in which a rise in prices threatened to reduce sales, output, and employment.

Unfortunately, the task of maintaining high employment under a conscious policy of inflation would prove even more difficult than under a policy of stable prices. Once it became known that the government was willing to accept any degree of inflation forced upon it by the combination of the wage-price push and its own determination to maintain high employment, expectations and actions throughout the economy would

speedily adapt themselves to the certainty of chronic price rises. There would be a general lessening of resistance to price rises because each buyer would hope to be able to recoup as a seller. There would be a general over-extension of credit, not only because borrowers would count on price appreciation of goods purchased on credit, but because the Federal Reserve would be compelled by its over-all policy to keep credit plentiful. The lack of buyer resistance to price increases and the heavy reliance on credit would further intensify demand and hasten additional price rises.

Interest rates, instead of being low as might at first be imagined because of the easy money policy, would rise to unprecedented levels because lenders would demand rate compensation for the expected decline in the value of the funds lent. If legal ceilings were placed on interest rates, the supply of loanable funds would decline drastically and there would be a strong shift of investments to the stock market and to the holding of real property. Because of the increase in speculative activity and the necessity for greater attention to all sorts of attempts to hedge against price increases, productivity would decline so that although dollar measures of economic activity would reach new heights, our real standard of living would decline. In the end, the spiraling boom would probably collapse in a mass loss of confidence in the government's ability to control the economy—and the resulting decline would be far more serious than the mild type of setback we have experienced from time to time in recent years:

The conclusion is inescapable that if we attempt to achieve the goal of high employment by sacrificing the goal of price stability, we will end up with neither stable prices nor high employment. Inflation intensifies, rather than

cures, the basic factors which endanger the goal of high employment.

STEPS TOWARD OUR BASIC ECONOMIC OBJECTIVES

The preceding discussion has indicated that price stability should be a primary objective of national economic policy—first, because inflation encourages and facilitates injustice in the distribution of our economic output, and second, because inflation lessens, rather than improves, our ability to maintain high employment and growth. The discussion has also indicated, however, that under conditions as they exist in the American economy today, there are periods—particularly in the later stages of a boom—when it may prove very difficult to maintain both high employment and stable prices. During such periods, monetary and fiscal policy is faced with a dilemma under which actions designed to maintain employment are likely to lead to inflation, and actions designed to maintain stable prices may result in declining employment.

Those who have failed to think the problem through have proposed that we escape this dilemma by abandoning the goal of price stability, accepting chronic inflation as a means of maintaining high employment. More careful thought indicates, however, that inflation would not solve the problem. At every assumed rate of inflation the monetary and fiscal authorities would again be faced with the situation in which an attempt to hold the price rise to the assumed rate would endanger employment. The goal of stable prices would have been sacrificed, yet the dilemma would remain.

If it is difficult, under conditions existing in the American economy today, to maintain high employment with stable prices, and even more difficult to maintain high employment with infla-

tion, must we throw up our hands in despair and conclude that continued high employment is an unattainable dream? Not at all. What we must do is revise some of the catchy sayings which pass for economic truths so as to disclose the real nature of the problem. It is not stable prices and high employment which are incompatible; it is unrestricted and unrestrained monopolies and high employment which are incompatible. High employment is more attainable under stable prices than under inflation. But there is no government policy short of forced labor which can consistently maintain high employment when monopoly groups possess unrestricted power to force up wages and prices.

The American public is beginning to recognize the connection between excessive wage demands and inflation; there is still insufficient recognition of the connection between excessive wage demands and unemployment. It has long been recognized that a business monopoly is bad for two reasons—because it may appropriate an unfair or unjustified share of the output of the economy by raising the price of its product and because raising the price of its product is likely to result in restriction of real output. These same socially undesirable results flow from the abuse of unrestricted labor monopoly. Excessive wage demands by unrestricted labor monopolies result in inequity and unemployment just as surely as do excessive price demands by business monopolies.

What, then, is the solution to the problem? The solution does not consist of embarking on a "union-busting" program designed to bring labor leaders to their knees. In the first place, a labor union is not the only pressure group which uses its privileged position to gain, through inflation, at the expense of less powerful groups. The federal

government itself engages in all sorts of programs designed specifically to raise the price of products produced by powerful voting blocs. There are too many instances where business has made little effort to pass along the benefits of improving productivity to consumers via lower prices, and then has pointed an accusing finger at labor for employing the same technique. There are continued attempts to maintain prices, or reduce competition, through contracts between manufacturer and retailer. There are attempts to maintain prices by excluding foreign competition through tariffs or import quotas. Labor unions are not by any means the only example of the use of economic or political power to raise prices; the attempt to curb abuse of monopoly power should not be made an excuse for labor-baiting.

In the second place, there is no question that labor must have the legal right to monopolize, that is, to act in concert through a labor union if it is to achieve equal footing with the employer. The problem arises from the fact that we have not yet discovered methods of imposing sufficient safeguards to prevent the abuse of this legal monopoly grant. The grant has been so broad that it has extended to labor unions' rights and immunities completely outside the sphere of employer-employee relations. The irresponsibility inculcated by these immunities has done more to encourage the abuse of labor union power—and to hurt the prestige of labor unions—than has the grant of economic monopoly itself.

It has been proposed that the problem might be solved by limiting the size of labor unions—for example, by prohibiting industry-wide bargaining through limitation of a single union to the employees of a single corporation. Although it would be possible to so limit the size of a union, it is doubtful whether in practice this limitation would

prevent industry-wide bargaining. On both the union and the industry side, there would undoubtedly be agreements to act in concert and it would be difficult to prevent these behind-the-scenes agreements.

A more reasonable approach is one which is in fact being developed in the process of bargaining. During the post-war period there has been a growing tendency for all employers in an industry to act in concert for the purpose of bargaining. It is quite possible that the spread of this practice will erect a countervailing force of about equal power to industry-wide unions so that neither business nor labor may gain sufficient ascendancy to use its power to injure the public. A danger in this development is the possibility that management and labor in a given industry may join forces to exact tribute from less powerful industries. This danger is heightened where products which compete with each other, for example, steel and aluminum, are organized into a single union. For this reason, it may be necessary in the future to limit a single union to a single industry or craft.

In addition to the development of a countervailing force through concerted employer bargaining, a solution to the problem is likely to be found along the following lines: (1) Pressure must continually be brought on management to make it difficult to raise prices and

to force management to resist wage increases which are so large as to necessitate price rises. This pressure should take the form, first, of a vigorous anti-trust program; second, of a monetary and fiscal policy which has price stability as one of its primary aims; and third, of a public opinion which recognizes the true nature of inflation as a device for enriching the strong at the expense of the weak. (2) Labor law must be amended so as to safeguard the economic monopoly power of the labor union but remove the unreasonable immunities which have led not only to the use of physical violence as a means of settling economic differences, but also to the deprivation of the rights of labor union members. I am convinced that most labor union members are sufficiently concerned with the general welfare, and sufficiently aware of the danger to their own self-interest from the exercise of unrestricted monopoly power, that they would endorse reasonable limits on that power.

The problem facing us is not whether it is possible to have both high employment and stable prices, but whether it is possible to have both high employment and unlimited monopoly. The acceptance of inflation will not solve this problem. We can maintain high employment and an equitable distribution of output only by taking steps to restrain monopoly power, wherever it may exist in the economy.

Taxation and Inflation

By HAROLD M. GROVES

ABSTRACT: It is adequacy of taxation in the quantitative sense and in relation to public expenditure that is the most important aspect of taxation for inflation control. A well-developed public economy financed by a progressive tax system supplies a powerful automatic check on fluctuations in the private economy. A less progressive tax system would have some advantage in its reduced impingement on savings and incentives, but the advantage would not be large nor important enough to offset considerations of equity which must be weighed in the balance. As to state and local taxes, the federal government could do more to protect the states from interterritorial competition—income tax credit—and it could provide a more flexible support for state public works than tax-exempt securities. Several tax gadgets for inflation control are reviewed but none appear to be politically or otherwise promising at present. Nevertheless it must be recognized that oligopolistic practices in industry are a major factor in the present inflation problem. Fiscal policy, including its tax element, is important for counterinflationary purposes, but it encounters powerful vested interests, and it should not be our sole reliance in a stabilization program.

*Harold M. Groves, Ph.D., Madison, Wisconsin, is Professor of Economics at the University of Wisconsin. He was Chief of Staff of the Committee on Intergovernmental Fiscal Relations, United States Treasury, and is a director of the National Bureau of Economic Research. Dr. Groves is author of *Financing Government* (1939); 5th edition (1958) and *Postwar Taxation and Economic Progress* (1946) and coauthor of *Federal, State and Local Government Fiscal Relations* (1943).*

INFLATION itself may be regarded as a tax—uncertain, capricious, and regressive in its incidence. If some practical manipulation of the tax system could be devised that would check price fluctuations everyone would applaud.

Our treatment of this subject divides itself into three parts: the first deals with quantitative issues or aggregative taxation; the second treats the qualitative side—which of the familiar taxes is most efficient against inflation—and the third introduces special proposals, “gadgets,” that offer to promote our objective.

QUANTITATIVE ASPECTS

Before the so-called “Keynesian revolution” students of public finance were primarily concerned with three issues: the welfare implications of public spending; equitable distribution of the tax burden; and the incidence of taxation. The public economy was conceived much like a private household, only larger. Now a fourth area has been added, and the concept of the public sector has been changed. The area, frequently termed “fiscal policy,” considers the manipulation of public expenditure, taxes, and debt management to serve the goals of stability, full employment, and adequate growth. Government finance is regarded as a balance wheel or control factor to keep the private economy functioning in accordance with accepted objectives.

In the older dispensation, the canons of taxation stated and elucidated by Adam Smith were accepted with qualifications as covering the objectives of the tax system: taxes should be equitable, certain, convenient, and economical. Now a new canon has been added, namely that taxes should be adequate. The fifth canon might be supposed to refer to a sufficiency of revenue to sustain approved public services. But it

is now generally given a more special interpretation; namely, that taxes should be adequate to prevent inflation. This conception is frequently associated with Abba P. Lerner who startled the fraternity of public finance scholars with the proposition that “the purpose of taxation is never to raise money but to leave less in the hands of the taxpayer.”¹ So far as meeting the public payroll is concerned, printing money would serve as well as extracting it from the taxpayer. Even Henry Simons, never classed as a Keynesian, accepted the view that adequacy should be regarded as a sovereign objective of taxation and “adequacy is simply the inflation problem.”² The least that can be said specifically about adequacy of taxes in a peacetime situation where inflation threatens is that they should bring in enough revenue to finance current expenditures. The application of this rule to the present loophole-ridden tax system of the United States in the present juncture of public affairs we leave to the reader.

War finance

Apply this conception to war finance. Here we start with an unbalanced budget and inflexible public expenditures. The hypothesis is that of the several ways of supplying the deficit, augmented taxation will be the least inflationary. Printing money or borrowing from banks, which amounts to much the same thing, will add to the purchasing power of the public the full amount of the deficit at a time when the public is receiving more income than it can spend on available goods at current prices. Selling bonds to nonbank purchasers could absorb private purchasing power, but such purchasers are likely

¹ *The Economics of Control*. (New York: The Macmillan Company, 1944), pp. 307–308.

² *Federal Tax Reform*. (Chicago: University of Chicago Press, 1950), p. 4.

directly or indirectly to use their new assets as security or pretext for enhanced private borrowing. Taxation, on the other hand, leaves the private sphere with less current income and no new assets. It is the logical device to induce a substitution of public tanks for private automobiles. However, the taxpayer may insist on maintaining his customary purchases even if he has to borrow to pay taxes. If monetary restraints were tight enough to prevent this, a genuine substitution of public for private demand could conceivably occur, and the case would not differ from that where private demand shifts from automobiles to television sets. But monetary restraints are very unlikely to provide this check; such a tight money policy would be deemed a threat to maximum war production. In other words, the monetary restraints could not be sufficiently selective to curtail nonessential without impeding essential output. Thus we must have some wartime inflation no matter what the financial program. But this does not defeat the hypothesis that financing war by taxation is the least inflationary of the alternatives.

However, there is another aspect to consider and this is the possibility that taxes may adversely affect the supply side of the market through their impingement on incentives. Instead of working overtime the labor force might give up and go fishing. Of course, some people might also work harder and longer in order to keep up with the tax. But historically it was concern for incentives, along with disagreement about kinds of taxes to be levied, that set the limits to tax financing during World War II. Nevertheless many people, including the author, are of the opinion that taxation during this period was "inadequate" and that the inflation problem could have been eased substan-

tially had we then achieved more fiscal courage.

Peacetime inflation.

Analysis of war finance can be transferred in the main to the problem of checking inflation in a cyclical boom, or a secular tendency toward rising prices in peacetime. But there are some differences. Here the budget may be balanced and counterinflationary effects of taxes must be achieved through a budgetary surplus. A new problem appears in disposing of the surplus. Logically it at first appears that reduction of the public debt held by banks will reverse the process by which purchasing power and the quantity of money had become unduly expanded in a previous period. But the expansion process may not be reversible. Paying banks money for securities will replenish bank reserves and thus facilitate a private expansion of credit. Here again fiscal policy might need assistance from monetary policy. Or the difficulty could be avoided by retiring the debt held by Federal Reserve Banks. This would be tantamount to sterilization of the surplus receipts in the government's treasury.

Moreover, peacetime public expenditures are less inflexible than those of a war period, and this suggests an alternative means of achieving a treasury surplus.

There are those who would argue that heavy taxation to achieve a budgetary surplus is more likely to aggravate than to mitigate an inflation. Here we may refer briefly to the interesting debate associated with Colin Clark who argued that taxes above a certain limit in terms of a ratio to national income—for instance 25 per cent—must constitute an inflationary influence. The issue tends to become confused with the problem associated with high public expenditures. If the latter be accepted as in-

elastic, then the issue is between various ways of financing a given outlay. This has been discussed in connection with the war situation where it was concluded that taxes, within very wide limits, are likely to be less inflationary than alternatives.

In the peacetime situation the problem is still one of alternatives, but the alternative of reduced expenditures is now presumably open. If taxes are already very high, enhancing them will meet the objection that this will have an adverse effect on incentives. The political and economic inelasticities of both taxes and expenditures are the main road block to attacking inflation via government surpluses. It has often been noted that tax and expenditure practices are institutions with long run implications, including vested interests, and they cannot at the behest of fiscal policy be turned on and off like a spigot. One cannot build up an educational system over the years and then abandon it in a particular year, nor can one apply a death tax in inflationary years only. Politically, reduction in expenditures and enhancement in taxes are likely to be inelastic. Fiscal policy, then, is likely to be applied more effectively in coping with a depression than in checking an inflation.

But taxes have some economic elasticity which might achieve some surplus during inflationary periods even without rate increases or new levies. This is particularly true of a progressive tax system which is thus said to have "built-in flexibility." The volume of revenue will fluctuate not only in response to a change in tax rates but also in response to a change in income. With a progressive tax system this automatic fluctuation in revenue will also be greater than the fluctuation in income. In the case of the individual income tax, more income per taxpayer means higher effective rates even though the nominal

rates do not change. When Jones' income rises from \$2,000 to \$4,000 his income tax might quadruple. In the case of the corporate income tax the fluctuations in revenue greater than those in national income are due to the tendency of corporate profits to fluctuate more than other elements in income. There is also some built-in flexibility on the expenditure side of the budget as for instance where transfer payments for welfare and price supports can be reduced when national income is high. Built-in flexibility is a function of large budgets as well as progressive ones; here high taxes play a beneficial role, and the achievement of full-fledged peace might aggravate economic instability. It has been calculated that under conditions in the middle 1950's the built-in flexibility factor in public finance in the United States might compensate for fluctuations in private incomes to the extent of some 40 per cent of their magnitude.³

One school of thought has expounded the view that with the device of built-in flexibility, it should be possible to counteract instability without governmental intervention:

... set the tax rates to balance the budget and provide a surplus for debt retirement at an agreed high level of employment and national income. Having set these rates, leave them alone until there is some major change in national policy or condition of national life.⁴

No forecasting or decisions as to timing would be required. As the figure cited above indicates it would be optimistic to expect built-in flexibility to do the job alone of compensating fully for instabilities in the private economy. But

³ Richard A. Musgrave, *The Theory of Public Finance*. (New York: McGraw-Hill Book Company, 1959), p. 511.

⁴ Committee for Economic Development, *Taxes and the Budget* (New York: Committee for Economic Development, 1947), p. 22.

it can help, and the pessimists are likely to conclude that full use of its potentialities is about all that can be expected of (tax) fiscal policy in checking peacetime inflation. On this view also tax features legalized in 1948 that weaken progression, such as the splitting of income between spouses, are bad in terms of inflation control.

QUALITATIVE CONSIDERATIONS

In either a deflationary period or an inflationary period, but particularly the latter, the question will arise as to what kind of tax is most effective to check movements of prices and employment. Some writers have concluded that while progressive income taxes were well adapted to the period when fiscal policy doctrine was first formulated, the post-war period is characterized predominantly by an excessive and inflationary tendency to spend much and save little. In this situation consumption taxes would be more appropriate than income taxes, but we cling to the latter because of an intellectual lag.⁵

For consumption taxes as compared with income taxes in this context the following advantages may be claimed:

1. Consumption taxes are usually regressive which means that they fall with special weight upon the classes which have a high propensity to spend all or most of their incomes on consumption. The more affluent classes also spend their incomes, but in their case the outlay is largely on investment—either real investment, new capital, or existing shares in old investment. Real investment is thought to be more or less independent of saving; if it is not financed out of ample saving it will be financed by an inflationary expansion of credit. Thus, savings—even if not held idle—are counterinflationary. Moreover, in

the long run, investment will supply more goods to offset the money put in circulation to create it. Putting all of this together one can conclude that taxes which press lightly on the well-to-do are most effective in stopping inflation.

2. Consumption taxes offer the taxpayer an opportunity to avoid taxes by spending less and saving more. They are levied, so to speak, on the act of spending for consumption. They favor saving as against spending whereas income taxes are neutral between the two.

3. The effect of the above discrimination associated with consumption taxes is enhanced by a "money illusion." People whose incomes are cut by income taxes will adjust their budgets with full knowledge that they have less to spend and save. People whose real income is cut only by virtue of the fact that the same money income will buy less consumption goods—bringing higher prices—will, because they do not realize what is happening, seek to maintain the relative proportions disposed on consumption goods and savings. They will be defeated in respect to their outlay on consumption goods, and this will promote more saving proportionately.

4. The above arguments are in terms of equal revenue from the two taxes being compared. If this assumption is relaxed, one can advance a fourth argument; namely, that the addition of consumption taxes to a system dominated by income taxes can be pushed to yield more revenue than taxpayers would submit to pay by addition to an existing, heavily worked tax. In other words, diversity in a tax system is conducive to adequacy. Much was made of this point in promoting a general federal sales tax during World War II.

All of these points have been met with counterarguments. Studies of consumer behavior have suggested that the distribution of the tax burden, irrespec-

⁵ William D. Ross, "State-Local Fiscal Policy and Economic Growth," *National Tax Journal*, Vol. 10 (March 1957), pp. 67-77.

tive of its size, has a relatively minor effect on consumption at least in the short run. While groups with low income spend relatively more on consumption than do groups with high income, it does not follow from this that they react differently to a change in their incomes. Concerning the taxpayers' response to the built-in opportunity for avoidance of consumption taxes, this would in large part be defeated if the tax were permanent or expected to remain in effect a long time. Insofar as the taxpayer only saves for future consumption, as in retirement saving, he will be caught by the consumption tax eventually anyway, and he might as well maintain his existing habits. Nobody knows whether the "money illusion," conceded to be a highly ingenious discovery, actually fools many people for long. And the political resistance to consumption taxes may be quite as great as to additional income taxes. Add to all this the allegation that in the short run, which matters most here, stimulating investment may be as inflationary as favoring consumption.

The case against consumption taxes also stresses their escalation effects. Notwithstanding money illusions, labor may react much more positively to an increase in prices than to a decrease in disposable incomes. Such reaction is built into the system where escalator clauses in wage contracts assure wage increases when the cost-of-living index rises. Increases in wages following advances in prices are a familiar feature of the so-called inflation spiral.⁶

⁶ The point is not to be confused with the contention that sales taxes must be inflationary because in their case higher prices are the means of collecting the tax. The invalidity of this contention is generally conceded; the higher prices, in the case of the sales tax, transfer purchasing power to the government and are quite a different species from the higher prices that are part of the private inflationary spiral.

The positive case for progressive income taxes includes the built-in flexibility feature already explained. This relieves the counterinflationary tax program from the political inelasticities associated with properly timed tax legislation to meet the vicissitudes of the business cycle.

On balance it may be concluded that consumption taxes may have some advantage over income taxes as a tool of counterinflationary fiscal policy, but that the difference—quantity assumed equal—is not great. It must also be noted that the price effect of alternative taxes is only one among many, and that other advantages of one tax or another—greater equity, for instance—might outweigh this consideration. Particularly important in this regard is the fact that temporary tax measures leave permanent effects on future choices.

Expenditures and state and local taxes.

Concerning the equity aspect of taxes in relation to their fiscal policy aspect, much can be said for an over-all expenditures tax. It will be recalled that this was one proposal which the Treasury submitted during World War II to increase the proportion of war cost that would be borne by taxation. The over-all expenditures tax may be conceived with some simplification as an ordinary progressive income tax with saving exempt. It may also be conceived as an over-all rationing program under which one could spend as he pleased but be fined for spending excessively. It would avoid the disadvantage of other consumption taxes associated with their regressive incidence. However, special administrative difficulties are urged as a point against this form of levy, and as a standing feature of the tax system, which temporary use might involve, it could lead to, what some would regard as, an overconcentration of wealth.

Much has been said about the desir-

ability and the difficulties of bringing state and local governments into a co-operative role in national fiscal policy. During a depression this calls for such federal measures as supplementary unemployment compensation and aid for public works. Substitution of the latter for income tax exemption of interest on state and local bonds would be an improvement on several counts but particularly in its greater flexibility in exercising fiscal policy. As to state taxation, and looking both to depression and inflation, the federal government could give increased support for state and local taxes that have some built-in flexibility—notably the state income tax. The principal impediment to such taxation in the states is interterritorial competition. A federal credit of some sort like that used in unemployment compensation payroll taxes would give much more effective protection here than the present allowance of deductibility for state taxes in deriving the federal income tax base.

GADGETS

Especially during periods of price and wage instability, proposals to use taxes in their policing capacity abound. Most special tax incentive proposals are aimed at depression and unemployment, but there are also devices that aim to curb inflation. Among this latter group are proposals to tax bank loans, to disallow, perhaps partially, income tax deductions for advertising expense, to manipulate depreciation allowances, and to disallow, for a time, the deductibility to employers of wage increments.

Space does not afford the opportunity to discuss these proposals in detail. Some of them look promising, but they all suffer from the political impediments, such as vested interests, in their path. Depreciation allowances were liberalized in 1954; this was in response to the contention that prevailing practices did

not provide capital to replace worn-out equipment as rapidly as the equipment wore out. The point is a highly controversial one, and the present statute is maintained by a balance of power among powerful economic and political interests. Probably neither friend nor foe would respond to the invitation to change the formula with every economic wind that blows.

We have mentioned above that we can expect chronic inflation if the average propensity to spend is too high. Concerning more saving it is also argued that a shortage here limits economic growth. If these views are valid some discouragement of advertising and consumers' credit would seem in order. But there are also many who still fear redundant saving and see no real basis for concluding that the rate of economic growth has been hampered by a deficiency in saving. There are few, if any, areas today where productive capacity does not substantially exceed demand. Some of the same people who deplore the impact of progressive taxation on thrift would shout loudest against any means of reducing consumers' interest in buying the so-called "good things of life."

It should also be noted that there is increased following for the view that the current problem of inflation is due primarily to oligopolistic practices in industry and labor unions. An augmented money supply is required to support the higher levels of administered prices, but it follows as effect rather than preceding as cause. In recent years inflation has persisted despite budgetary surpluses, monetary controls, and recession. The gadget listed above which would go directly to this "cost-push" aspect of inflation is the one which suggests tax pressure on employers who grant wage increases. But it looks like too crude a weapon to achieve its objective. It is doubtful if anything

short of direct controls can go to the root of administered-price inflation. But it does not follow that fiscal policy in this situation has lost all of its relevancy.

CONCLUSION

Re-examining what the writer has contributed on his subject, he notes that it is predominantly negative in tone. Control of the quantity of taxation with inflation in view is important, but except for the built-in flexibility which attends a progressive tax system and a huge budget—features which developed fortuitously—we have not, nor are likely to make much use of it. As to qualitative distinctions in the tax system, inflation analysis suggests minor

advantage for the sales tax but not enough in the author's opinion to warrant changing the emphasis of the present tax system. Tax gadgetry is principally of academic interest.

Nevertheless, it remains true that hardly anybody now regards balancing the federal budget as involving no more economics than is at stake in balancing his private accounts. We made commendable efforts to finance recent wars by taxation, and we cut taxes once during 1954 in a deflationary phase and came close to doing so again in 1958. As to tax policy, the Keynesian revolution is genuine and important, but it has not replaced everything else either in ordering the tax system or in inflation control.

Income Taxes and Inflation

By MARTIN R. GAINSBROUGH and J. FRANK GASTON

ABSTRACT: The income tax, which has been regarded as the chief weapon in the battle against inflation, has come to be scrutinized as a possible factor in inducing inflation. Prior to World War II, the comparatively low rates of corporate and personal income taxation made such taxes appear relatively unimportant. High rates of taxation, however, have been carried over to the postwar period and, consequently, have served to focus attention upon the effect of such taxation upon economic growth and stability, distribution of income, and the efforts made by corporations and individuals to pass along the higher rates of income tax as well as the effect that these taxes may have on savings and investment. Until fairly recently, it was generally expected that business corporations and the stockholders bore the burden of the corporate income tax. This absorption theory has been giving ground to the shifting theory which maintains that under present-day competitive conditions, the corporation is able to shift taxes in the form of higher prices. Empirical studies have noted an increasing tendency for businessmen to say that they take income tax increases into consideration when setting prices. With respect to the personal income tax, there is growing reason for believing that work incentives and willingness to make risk investments are adversely affected and that efforts are made to pass along higher income taxes in the form of higher wages and salaries.

Martin R. Gainsbrugh, New York City, is Chief Economist of the National Industrial Conference Board and Adjunct Professor of Economics, New York University.

J. Frank Gaston, New York City, is Director, Division of Consumer Economics, National Industrial Conference Board.

THE income tax, both corporate and personal, is still widely regarded as one of the major means used by government to combat inflation. Primary reliance was placed upon such taxes for this purpose during World War II. High, normal, and excess profits taxes were imposed upon corporations, and steeply progressive rates of personal income tax were applied against individual income. True, the justification for high wartime rates did not rest solely upon the control of inflation alone. But extremely heavy emphasis was placed upon the need to siphon off excess personal or corporate income to restrain civilian demand.

The postwar years bear further witness to the primary reliance upon income taxes for revenue purposes. Income taxes are now the mainstay of the tax system. They comprise about three-fourths of all taxes. As compared with 1939's tax of 12½ per cent—16 per cent on corporate income below \$25,000 and 19 per cent thereafter, the general rate today is 52 per cent. One may well ask whether continued primary reliance upon such a tax to meet today's problem of cost-induced inflation is as warranted as it was when such taxes were first raised to restrain excessive civilian demand. Is the income tax as effective a weapon in the battle against the wage-cost-price push as it

is in restraining the war-engendered "demand-pull"?¹

The mechanics through which income taxation operates in controlling war-induced inflation are essentially simple. Income accruing to businesses and individuals so taken limits present or potential civilian demand for goods and services. The increased income tax revenues in turn help to finance the war. Demand by government continues to push up prices, but far less than might have been the case had government financed its war needs through heavier borrowing and less tax revenue.

Heavy as the income tax levies of World War II may have seemed to many and effective as they proved to be in restraining the orthodox type of inflation—that is, too much money chasing too few goods—there are some who say it did not go far enough. More stringent taxation, they argue, would have prevented the wartime buildup of liquid assets and the subsequent "demand-push" inflation that characterized the first postwar decade.

POSTWAR LEGACY OF HIGH INCOME TAXES

Whatever the merits of even higher wartime taxes, a disturbing legacy is the continued high rate of individual and corporate income taxation. The current rates, while below those of the war, tower above those existing earlier. Table 1 shows the higher effective average rates. Statutory rates are hard to compare because of tax law changes. The continuance of such high rates during the first postwar decade have raised many new questions about taxation, in-

TABLE 1—EFFECTIVE INDIVIDUAL AND
CORPORATE TAX RATES

YEAR	FEDERAL TAXES AS PER CENT OF PERSONAL INCOME	STATE AND FEDERAL CORPORATE INCOME TAXES AS A PER CENT OF PROFITS BEFORE TAXES
1929	1.5%	14.2%
1939	1.7	22.5
1944	10.6	55.5
1948	9.0	37.8
1958	10.2	49.0

Source: United States Department of Commerce.

¹ For the first extended discussion of the change from "demand-pull" to "cost-push" pressures upon price and the economic implications of this change in inflationary environment, see The Conference Board Economic Forum, *Wage Inflation*, "Studies in Business Economics," Number 56 (New York: National Industrial Conference Board, 1957).

cluding the taxable capacity of a nation or an individual. The term "capacity" embraces not only financial ability but also the degree of tax resistance or unwillingness to pay taxes that high rates have provoked, leading both to tax minimization and tax evasion. Businessmen grow ever more conscious, too, of the cost and inconveniences of tax compliance, much of which they maintain is unnecessary.² Some, like Colin Clark, have even advanced the proposition that 25 per cent of national income may well be the economic limit of taxation which a nation is prepared to accept in peacetime.³ Other questions that have arisen

² For a recent survey, see "The High Cost of Tax Compliance," The Conference Board Business Record, August 1959.

³ "This now brings us to the question of whether there are any grounds for hope that the 25-percent limit could be safely exceeded, and if so, under what circumstances. As you will see from the original articles in *Economic Journal* and *Harpers* the 25 percent is a round figure rather than a precise limit and should certainly be written 24-26 if not 23-27. When, however, your figure is as high as 27 I should say myself, I would be willing to bet with a fairly high degree of probability on a further increase of money wages and consequent inflation to the national income as a whole.

"If taxation of this order of magnitude appears unavoidable, you may then ask whether there is any form or form of taxation least likely to cause an upward pressure on prices and incomes.

"Under circumstances envisaged with an inescapable necessity of imposing taxation at a level of 27 percent or more, on national income, we can minimize the upward pressure by a system which, in general terms, keeps down marginal taxation with consequent necessary raising of average rates of taxation. Such a program, it need hardly be pointed out, would be extremely unpopular. It would mean removing, where possible, the progressive elements in the tax system, charging lower rates on the high incomes and higher rates on the low incomes, relying upon indirect rather than direct taxation, and making indirect taxation fall upon necessities rather than upon amenities." Colin Clark, Letter to Joint Committee on the Economic Report, dated January 18, 1952, published in the *January 1952*

relate to the impact of high taxes on economic growth and stability on incentives to work and to invest, on the distribution of income, and on patterns of consumption.⁴

One effect that high income taxes may have upon the price level is the bias they create toward free spending for various types of business expenses. Growing concern was expressed during the war about the so-called "nineteen cent after-tax dollar" and the wasteful expenditure that it induced. So long as a dollar of expenditure could qualify as a business deduction, after-tax income would be reduced by only nineteen cents; the remainder represented the effective rate of the excess profits tax.

Even today, with the corporate tax rate of 52 per cent instead of 81 per cent, business expenditures as well as financial decisions (for example, the cost of borrowing) are still affected by after-tax considerations. The point still has validity, but it is not as acute as it was with the high wartime excess profits tax rates.

INCOME TAXES AND PRICE THEORY

A more recent concern is the relationship of high income taxes to prices and inflation. Until fairly recently it was generally accepted, at least among theorists,⁵ that business corporations bore

Economic Report of the President. Hearings Before the Joint Committee on Economic Report, Congress of the United States, 82nd Congress, 2nd Session, January 23-February 1, 1952 (Washington, D. C.: United States Government Printing Office, 1952), p. 316.

⁴ As an indication of official concern with these and other problems, see the Joint Committee on the Economic Report, *Federal Tax Policy for Economic Growth and Stability: Papers Submitted by Panelists Appearing Before the Subcommittee on Tax Policy*, November 1955 (Washington, D. C.: United States Government Printing Office, 1956).

⁵ Businessmen have generally dissented to the proposition that income taxes cannot be shifted, but their position has been looked

the burden of a corporate income tax. That thesis held that corporations were unable to shift such taxes either forward to consumers in the form of higher prices or backward in the form of lower wages. In a competitive economy, the argument ran, business firms produced up to the point where their marginal revenue—that is, additional dollar of revenue—equaled their marginal costs, thereby maximizing their profits. Hence a higher tax on net profits which would not affect costs would simply result in a higher share of the profits going to the government in taxes. The point of maximum profits would not be changed. Further, the relative position of all companies making the product would remain unchanged. None could change his output or price for fear of losing sales to his competitors.

This older theory has been increasingly challenged over the past decade and a new theory of incidence has come to be regarded as having large elements of truth. The new theory maintains that the corporation is able to shift the income tax in many more situations than was first thought possible. Following Terborgh,⁶ the newer theory empha-

upon by theorists as resulting from the businessman's inability to understand the complexities of price and tax theory.

⁶ See George Terborgh, *Effect of Corporate Income Tax on Investment* (Washington, D. C.: Machinery & Allied Products Institute and Council for Technological Advancement, 1959); see also Terborgh's incisive comments on incidence in *Fortune*, July 1959, p. 91, particularly: "If the incidence of the corporate income tax is to be inferred by comparing after-tax rates of return in the recent high-tax period with those of earlier low-tax periods such as the Twenties, it is obvious that the conclusion will depend on the kind of return employed for the comparison. If it is the return on sales or output, the inference will be that the tax has been largely absorbed. If it is the return on investment, the tax will appear to have been largely shifted.

"While such historical comparisons cannot prove anything one way or the other, they are certainly of evidential value . . ."

sizes "shifting" in contrast to the older thesis of "absorption."

TWO THEORIES OPPOSED

The main lines of argument of the two schools are well presented in this digest by the Joint Economic Committee:

The debate over the proper place of the corporation income tax in the revenue system is complicated by disagreement with respect to the incidence of the tax. According to one view, a substantial portion of the total corporate levy is shifted forward to consumers through price adjustments reflecting the tax, while most of the remaining burden is shifted backward to shareholders and to the productive services employed by corporations. Such an incidence pattern characterizes the corporate income tax as a sales tax. In this case, the argument that corporate taxes should be eased to increase the financial resources required for noninflationary expansion of investment loses much of its force. In addition, this type of incidence pattern makes the corporation income tax subject to the criticism frequently directed against consumption taxes with respect to their inequitable burden distribution and adverse effects on competitive relationships. Proponents of this view generally argue that corporate income taxation should be assigned a relatively minor role in the revenue system and should be regarded primarily as a device for source collection of shareholders' income-tax liabilities.

Opposed to this position is the view that the corporation income tax is not shifted, at least in the short run. It is argued that the most profitable output of the corporation in the short run is the same whether or not an income tax is imposed. Accordingly, so long as demand remains unchanged short-run price adjustments intended to pass on changes in corporate income-tax liability will not increase the corporation's profits after tax. While proponents of this view concede that over the long run the corporation income tax may be reflected in the price structure, they nevertheless hold that alternative methods

of taxation which would produce the same revenue would have a significantly more adverse and more immediate impact on the distribution of real income and on economic growth and stability.⁷

Basically, the "shifting" theory maintains that the assumptions of the "absorption" theory are far from valid in today's market place. Competition is imperfect and product differentiation is the rule rather than the exception. Further, it is held that the present pricing policy for a variety of reasons is not one that aims at maximizing profits. Rather, a "reasonable" or "fair" profit is regarded as more nearly describing the goal of businessmen. Consequently, the possibility of price change exists.

For all of the above reasons and others, the belief that considerable shifting does take place is gaining greater currency. The nearer the "shifting" theory is to the truth, the more likely it is that a tax rate on corporate income of 50 per cent may have an appreciable effect in influencing prices. Just how much influence it exerts remains highly speculative.⁸

RATE INCREASES AND SHIFTING

Certainly one may say with some authority that as tax rates increase, more and more personal thought and

business effort will be devoted to ways in which such taxes might be recouped. The findings of the three studies already cited support this point of view. Even in the earliest study, reflecting the views of businessmen in the mid-1920's when the corporate tax rate was 12 per cent, nearly a fourth of the replies from manufacturing firms indicated that the corporate income tax was reflected in prices. The study by Ellis can be taken to represent the opinion of businessmen just prior to our entry into World War II. At that time—when the corporate normal and surtax rate was 31 per cent for income above \$25,000, plus an excess profits tax which ranged from 35 per cent on the first \$20,000 of adjusted excess profits net income to 60 per cent on amounts in excess of \$500,000—slightly more than a fourth of the replies, from manufacturing and non-manufacturing companies, indicated that the corporate income tax would influence price policy, a percentage not very different from the study of the 1920's.

In Kimmel's inquiry relating to the middle of 1948, 60 per cent of the replies from manufacturing companies indicated that they took income taxes into consideration when setting their price policy. At that time, the rate was 38 per cent. To throw more light upon the influence of the tax rate, a further question was directed to the 60 per cent who replied that income taxes influenced pricing policy. They were asked if their answer would be the same if the corporate tax rate in 1946-48 was "in the range of 10 to 15 per cent." Four-fifths of them replied that their answer would have been different.

In addition to the direct raising of prices in order to recoup the income tax, George Terborgh⁹ maintains that there is another and more important way in

⁷ Joint Economic Committee, *The Federal Revenue System: Facts and Problems, 1959* (Washington, D. C.: United States Printing Office, 1959), p. 26.

⁸ Three comprehensive inquiries have been made in the United States among businessmen concerning, among other things, the effect of income taxes upon prices. These indicators of the attitude of the business community toward high corporate income taxes are: National Industrial Conference Board, *The Shifting and Effects of the Federal Income Tax*, 2 Volumes (New York: National Industrial Conference Board, 1929, 1930); Paul W. Ellis, *The Effects of Taxes Upon Corporate Policy* (New York: National Industrial Conference Board, 1943); Lewis H. Kimmel, *Taxes and Economic Incentives* (Washington, D. C.: The Brookings Institution, 1950).

⁹ *Effects of Corporate Income Tax on Investment*, *op. cit.* (note 6 *supra*), pp. 10 ff.

which the income tax affects prices. It does so by constituting a barrier to new investment and it thus reduces the supply of goods over what would be the case in the absence of such taxes as well as increasing their costs.¹⁰ Terborgh stresses that,

The present corporate levy of 52 per cent on taxable income is equivalent to a rate of 108 per cent on the after-tax return required to justify investment. If that return is 10 per cent, for example, the tax is 10.8 per cent of investment, the combined rate being therefore 20.8 per cent. What the tax does, in effect, is to raise the required pretax return to this rate. This alters the "terms of trade" between capital charges and operating advantage to the detriment of the former.

The increase in the required pretax return automatically excludes a whole range of investment projects that would be eligible in the absence of the tax, or at a lower rate. It limits eligibility, in other words, to projects of great urgency. The result is the deferment of both new business ventures and investments in the improvement of existing operations until their expected pretax return rises to the higher requirement.

EFFECT ON INVESTMENT

High corporate income taxes may not only cut off new investment, but such taxes also affect the volume of investment simply through reducing income after taxes. Should dividend payments be reduced correspondingly, retained

earnings could be kept where they were; consequently, funds from the latter source for investment would not be affected. The cut in dividends, however, would reduce the ability to attract outside capital. Conversely, were dividend payments maintained, retained earnings would be reduced and less funds would be available from the latter source. In either event, the net effect is to cut the total amount of funds available for new business investment; that is, the amount that is generated internally through retained earnings plus the amount that can be attracted from the capital market through a high dividend rate.

ACCELERATED DEPRECIATION

Accelerated depreciation, that is the ability to charge off the cost of the equipment in less than its useful lifetime, would tend to foster investment in expanding phases of the business cycle and to contract them when business activity was on the downgrade. This phenomenon would occur simply because more funds would be available through the introduction of such a device when business profits were good and would not generate any additional funds on the downgrade when business profits were either low or actual losses were being incurred. This conclusion would have to be modified, of course, as a result of the possibility of offsetting current losses against past profits and, consequently, receiving a tax refund. Further, the possibility of recouping the original investment through accelerated depreciation should have a buoyant effect on investment even in periods of business depression.

One other effect might be expected from accelerated amortization. It might result in the more rapid replacement of durable assets. This might occur because the advantage of large depreciation allowances would be exhausted presumably when the cost of the asset had

¹⁰ "Since three-quarters of the output of the private economy comes from the corporate sector, the problem of accelerating economic growth is to a large extent the problem of increasing the incentive for corporate investment and enlarging the supply of capital funds to finance it. Our own studies indicate that the corporate income tax runs counter to this objective whether absorbed or shifted. Other countries know this and are taking steps to mitigate its harmful effects sometimes by rate reductions, more often by accelerated depreciation write-offs." (Terborgh, *Fortune*, *op. cit.* (note 6 *supra*), p. 91.

been recouped from current income. In order to continue this, new assets would have to be acquired to replace those against which no further depreciation allowances would be permitted. Powerful incentive might be given to the rapid replacement of durable equipment. Whether this rapid replacement would accrue in some over-all social gain, or whether it would be at an excessive rate is a question that might require further examination.

There are other aspects of the relationship between high corporate income taxes and inflation that cannot be mentioned here for reasons of space. Outstanding among these is the inadequacy of depreciation allowances, for example, in a period of rising prices. This may limit investment at such times and thereby reduce the ability of industry to offset the "cost-push" of higher material and wage costs through expanded capacity, greater mechanization, and heightened productivity. A productive service will have been performed by the above comments, however, if they serve to raise questions concerning the extreme reliance that is placed upon the corporate income tax as a weapon against "cost-push" inflation.

PERSONAL INCOME TAXES AND "COST-PUSH" INFLATION

The personal income tax, because of its sheer magnitude, can have not only an effect on individual incentives and the willingness and ability to make risk investments, but even more on the individual's propensity to absorb his share of the tax burden or to shift it in terms of higher wage-salary demands. With respect to the willingness and ability to make risk investments, the conclusions of one authoritative study are worth quoting:

The tax structure, as of 1949, cut substantially into the investment capacity of the upper income and wealth classes—the stra-

tegic source of venture capital for investment in business—and, on balance, it also decreased the willingness of these investors in the aggregate to make equity-type investments. In other words, for equity-type investments considered as a whole the investors who were induced by taxes to shift to less risky investment positions appear to have overbalanced the opposite reaction of appreciation-minded investors. The latter group, however, may have been so stimulated by the tax structure to seek out investments offering unusually large capital gains potentialities, such as promising new ventures, as actually to increase the flow of capital to such situations. However this may be, it is clear that the combined impact of these effects fell far short of drying up the supply of equity capital which private investors were willing and able to make available to business. The evidence indicates that the accumulation of investable funds by the upper income classes has been consistently large during postwar years, despite the existing tax structure, and that individuals with large incomes and substantial wealth continue as a group to hold and invest a large proportion of their funds in equity-type investments.¹¹

With respect to the individual's propensity to absorb his share of the tax burden, there is even less, however, than in the case of the corporate income tax that one can offer as empirical evidence to support one point of view or another on the impact and effect of personal income taxes.¹²

¹¹ J. Keith Butters, Lawrence E. Thompson, Lynn L. Bollinger, *Effects of Taxation: Investments by Individuals* (Boston, Mass.: Graduate School of Business Administration, Harvard University, 1953), pp. 50-51.

¹² It is clear that raising taxes other than income will have a decided influence in raising prices directly and indirectly. Directly, the higher taxes represent increased prices of purchased goods and services. Sales taxes, excise taxes, processing taxes, postage, tolls, and others, are all reflected in the Bureau of Labor Statistics' Consumer Price Index upon which escalator contracts are based. Thus, indirectly, these increased taxes will also become the

One can point to several tendencies, however, which make it clear that efforts are made to pass along the personal income tax in the form of higher wages and salaries. It is not possible to say how effective these efforts are. With respect to wages, the emphasis in collective bargaining is upon the maintenance or even increase of take-home pay. The lowering of exemptions, the raising of rates, and the resort to withholding have served to focus attention on the amount the worker carries home with him—the amount that he regards as available to meet his everyday living expenses.

With respect to executive compensation, one may note the variety of means that have been employed to increase salaries and to reduce taxes. Thus, employee stock options, pension and profit-sharing plans, deferred-compensation contracts, all are employed in addition to salary to enable the employee to reduce his tax and also as an inducement to hold or attract valuable personnel. It is difficult to prove that such devices are necessarily more costly to the employer, but they are obviously grounded in the employee's desire to maintain take-home pay now and in the future and to minimize his tax liability. One question worth raising in this connection, but which cannot be discussed for lack of space, is the effect such plans have upon unincorporated businesses and the self-employed since, with the exception of deferred-compensation plans, these devices are not generally open to them.

High income taxes leave their impact

mechanism for wage increases through raising measured living costs. Personal income taxes are not reflected in the BLS Consumer Price Index, and, therefore, are not a part of this tax-price-wage mechanism.

on the desire of people to work and, perhaps, even on the occupations they may prefer. Income taxes have an important connection, too, with such decisions as an individual may make between increased labor or more leisure. For most people the enjoyment of leisure is predicated upon the availability of spendable income, and higher personal taxes may serve to reduce the desirability of leisure. To maintain a given level of living, an individual may well be compelled to work even harder to earn more income so that his level of living will not be impaired by higher taxes. This argument is frequently cited as a response to the loss of incentive argument. Again, there are some to whom work is either so habitual or who derive such pleasure from work that higher personal taxes have little influence on incentives. For others, however, higher taxes may serve to reduce the amount of work that they—particularly the skilled or gifted—are willing to perform. By their own standards of equitable taxation, too much of the additional dollar of income is siphoned off for social overhead. This attitude is reinforced where the income tax on individuals is steeply progressive, resulting only in a small addition to net spendable income for every dollar of gross income.

These people do not view the tax they pay as their proper share of the cost of services received from the government. They see little correspondence between the amount of taxes they pay and the services rendered to them by the government. The net result in many instances is a shift of the excessive tax burden where this is possible or a greater preference for leisure. In either event, wage-cost-price pressures are again intensified.

Taxation and Business

By EMERSON P. SCHMIDT

ABSTRACT: It is not obvious that taxes in themselves are a significant element in inflation. When taxes reach a level that is regarded as unduly high by a broad spectrum of taxpayers, protective and defensive reactions are likely to take place. Although the primary cause of inflation is the growth in the money supply resulting from deficit financing, even a balanced budget under certain circumstances can be inflationary. The corporation income tax is probably largely shifted forward to the consumer; but its level tends to defer new investment, and therefore has a price-lifting effect which, however, is not cumulative. A shift toward a tax system emphasizing direct rather than indirect taxes might help encourage opposition to government expenditure increases.

Emerson P. Schmidt, Ph.D., Washington, D. C., is Director of Economic Research of the Chamber of Commerce of the United States of America. He taught economics at several universities, leaving the University of Minnesota for his present position in 1943. He served as Chairman of the Manitoba Rural Electrification Inquiry Commission in 1942. He is author of numerous books, monographs and pamphlets and edits Economic Intelligence. He edited and authored most of the seventeen-pamphlet series used in the adult economic education program of the National Chamber. He is Chairman of the Business Research Advisory Council to the U. S. Commissioner of Labor Statistics and serves on the Budget Bureau's Advisory Council on Federal Reports. He is the founder of the Conference of Business Economists and a founder and a director of Automation Shares Inc.

THERE is general agreement that United States Treasury deficits financed by borrowing from the commercial banks or the central banks are closely related to inflation. Such financing increases the money supply and may reduce its buying power. But very little has been said about the level of taxes or the tax structure and inflation, except as related to the avoidance of deficits and generating surpluses in time of boom.

It is not clear whether taxes in themselves are a significant element in inflation; but to the extent to which they are important, their influences work themselves out through the various other inflationary forces in operation. Recent major studies of inflation virtually ignore taxes or the tax structure as inflationary causes. A few of them make passing reference to the subject, but in most cases the discussion runs in terms of bulging government expenditures, recognizing that any deficits may have inflationary impact.

Dr. Colin Clark, however, has repeatedly argued, in spite of criticisms of his position, that when governments absorb from 23 per cent to 25 per cent of the national income, inflationary forces are set in motion.¹ Under full employment it has also been demonstrated that a rise in public expenditure may force a rise in prices. Thus, Richard A. Musgrave states: "Under conditions of full employment, an expansion in the balanced budget cannot but raise prices. This will be true whether the increase in expenditures is matched by an increase in income or in consumption taxes."² This has come to be known as

the balanced budget theorem and is generally accepted. Thus, it has been said:

... not only are increased taxes politically unpopular, but, their effectiveness as an anti-inflationary device depends on the tax structure and the particular kinds of taxes being increased. When tax rates are already high, additional taxes may impair incentives and reduce output—or at least slow the expansion of output. Moreover, to the extent that additional taxes reduce money savings rather than consumption spending, they do not reduce total money demand, and they prevent capital investment from being financed in a noninflationary manner. On two counts, then, higher taxes may reinforce certain inflationary pressures, though in the aggregate taxes usually act as a deflationary withdrawal of purchasing power. At least, we should expect responsible fiscal policy during inflation to maintain taxes at a high enough level to produce a substantial budget surplus and to make some reduction in the public debt.³

Major or substantial and "galloping" inflation can be explained primarily by large increases in the money supply. Creeping or slow but more or less persistent, mild inflation, such as prevailed from 1956 into 1959 in the United States, can be understood in terms of lag effects, numerous pressures, economic rigidities, institutional arrangements such as wage escalation clauses, minimum wage fixing, and other forces.

OUTPUT AND INFLATION

Sometimes it is said that more and more production is the answer to inflation; again, it is argued that improved productivity is the answer, and in so far as a tax system retards growth or productivity, or both, the tax is inflationary. These answers are a part, but only a part, of the answer to inflation. They are only a partial answer because

¹ Colin Clark, "Public Finance and Changes in the Value of Money," *Economic Journal*, Vol. 55, Cambridge, England, December 1945.

² For the line of reasoning, see: Richard A. Musgrave, *The Theory of Public Finance* (New York: McGraw-Hill Book Company, 1959), p. 452.

³ *The Mechanics of Inflation* (Washington, D. C.: Chamber of Commerce of the United States, 1957), p. 47.

excessive monetization of public or private debt may exceed any attainable economic growth. The government printing presses or other fiscal and monetary operations turning out money—either directly through merely printing more money or through the sale of government bonds to the banking system—can always be made to outperform the growth in real output or the growth in the efficiency of the economy.

But the emphasis on more output and improved efficiency is on the side of less inflation, even though it may not be the complete answer. If so, anything, including a disincentive tax system, which stands in the way of more output and more efficiency is a roadblock.

In short, any forces which reduce output or the competitiveness of our economy tend to make it operate at less than optimum efficiency and higher real costs; but this is not what we generally mean when we express concern over major or persistent inflation problems.⁴

TAX REFORM

By changing our tax system in ways which will bring home to the taxpayer that he is paying, we may increase our ability to cope with inflation. This requires that he understand that he pays whether the budget is balanced or unbalanced.

In so far as pressures for more government spending are effective because the accompanying costs are underrecognized, a tax system which relies heavily upon pay-as-you-earn, or indirect and hidden taxes, encourages government spending.

Apparently, it has been easier to ex-

pand the programs and expenditures of the national government than of the state and local governments. This greater "elasticity" of the supply of the national government funds is partly due to differences in the tax structure of the national government from that of the state and local governments. The taxpayer is quite conscious of most of his state and local taxes. This is less true of national government taxes.

In 1958, out of nearly 70 billion dollars of national government budget receipts, about 50 per cent was derived from personal income taxes. The remainder was raised primarily by indirect or hidden taxes: corporations, 20 billion dollars; excises, 8.6 billion dollars; and 5.7 billion dollars from other sources—primarily indirect sources such as customs, estate, and gift and employment taxes.

Since the personal income tax rates are steeply progressive, reaching up to 91 per cent, apparently it is popularly assumed that the rich and those with above-average income pay the bulk of these taxes. This attitude, although it greatly exaggerates the degree of progression in practice, helps to reduce resistance to national government spending and, therefore, may contribute to inflation. The pay-as-you-earn withholding system, likewise, reduces tax consciousness. If the taxpayers generally understand that about 80 to 85 per cent of all personal income tax revenue comes from the basic 20 per cent bracket rate, resistance to taxes might rise and, thus in turn, might encourage more careful scrutiny of government spending proposals and the threat of deficit spending, assuming that the taxpayer also understands that inflation growing out of deficits is also a "tax" on him.⁵ Inflation also may raise

⁴ For suggestions on improving the mobility of production factors, see: *Disemployment Forces and Reemployment Prospects* (Washington, D. C.: Chamber of Commerce of the United States, 1959).

⁵ For the argument from a labor leader in favor of relatively more national government spending on the basis of the progressivity of

"effective" tax rates quite sharply as individuals are "inflated" into higher tax brackets.

Because of the heavy reliance on indirect taxes—nearly half the budget receipts—it may be assumed that the average taxpayers are generally not fully aware that they do pay these taxes too.

Taxes levied on business or collected via business are popular with politicians apparently because they assume that either business, and not the average citizen, pays or that while business must pass the tax along like other costs, the final incidence of these costs is hidden from the general taxpayer. The latter reason smacks of hypocrisy and is undemocratic in its overtones. The former is false because business per se is not taxed and does not pay taxes. Individuals pay taxes, even when the collector relies on a business unit as the collection medium.

While national sales taxes or taxes assessed on retailers on the basis of their sales volume are widely resisted, similar taxes levied at the manufacturers' level may be applauded. Even though, because of some tendency toward pyramiding, the latter may be more burdensome to the consumer than the former, the politician will nearly always favor the tax assessed against the manufacturer.

Similarly, the politician favors the pay-as-you-earn, withholding system, income tax with extreme progression because it reduces general opposition to taxation. Even if he has to fashion all sorts of exceptions, called "loopholes," to lessen the damage of the high rates, he prefers to keep the high rates and the steep progression.

A forthright downward revision of the largely ineffective, high bracket income tax rates and more emphasis on

retail sales taxes, rather than on hidden excises and corporation income taxes, would probably encourage much broader citizen concern with government spending and deficits and their inflation potential.

THE CORPORATION INCOME TAX

But perhaps the weakest link in our tax structure, in terms of fighting inflation, is to be found in the corporation income tax. This is so for several reasons. This tax amounts to about 52 per cent of most corporations' pretax income. When Uncle Sam becomes more than a 50 per cent partner in any enterprise, its owners may have substantial incentives to build up certain costs and to find ways and means of minimizing Uncle's share.

Professor Sumner H. Slichter of Harvard University has repeatedly argued that our corporation tax system minimizes the employers' resistance to excessive wage demands. Since about 50 per cent of any wage increase is, in effect, paid by a reduction of the corporate employers' income tax, the typical employer tends to be profligate, it is argued, in acceding to "inflationary" wage demands.

Whether this conclusion is correct or not, we have no way of knowing. It could have at least a marginal effect. Under a competitive economy, however, each employer is under significantly steady pressure to control his costs. Wages (and fringe benefits) constitute about 25 per cent of the typical manufacturer's costs. But for the economy as a whole, wage costs constitute more than two-thirds of all costs—twice as large as all other costs combined. Thus, what happens to wages is of the utmost importance to employers, in terms of both their direct and indirect employment costs.

It would be somewhat surprising, therefore, to find that employers, in

its tax structure, see: "Tax Plan Drawn for School Help," *New York Times*, December 18, 1955.

their wage policies, would be greatly influenced by their corporate income tax liability. Why should any employer burden himself permanently with higher labor costs merely because, for the moment, half of the increase can be absorbed by a reduced income tax on the business? Corporate income and earnings are highly volatile and uncertain. But a wage increase, once granted, is enduring and may pave the way for another increase a year later. In short, we have no evidence or reason to believe that the corporate income tax is an important factor in elevating wage costs.

But this may be less true for some other corporate operating practices. During the period when the so-called Excess Profits Tax was in force, with combined rates running as high as 80 per cent, there was widespread public discussion of the wastefulness of this high rate. The "waste" took the form of less diligence in restraining expense accounts and in placing and determining the volume of advertising.

It encouraged maximum expenditures on the maintenance of the properties and other items, because they were operating expenses, and this reduced the net income subject to the exalted tax rates. That there was much to these arguments can scarcely be denied. One corporate executive at that time told the writer: "We are sweeping everything under the rug." He did not tolerate sheer waste or profligacy; rather, all expenditures were made which would be of profit in the future, such as greatly increased advertising, stepped-up maintenance, additional investment in training personnel, and so on. Many similar cases could be cited.

With a 52 per cent corporate income tax rate, these same tendencies may be less pervasive and may be somewhat reduced. But it would be surprising if such a high rate did not encourage many

business practices which would be absent in the face of a more moderate rate or a zero rate.

The Internal Revenue Service (IRS) has greatly increased its investigations of corporate expenditures. It has challenged and disallowed many expenditure items and has issued a host of new rules disallowing numerous deductions. But with hundreds of thousands of taxpayers under its care, the IRS, even though it has thousands of revenue agents, cannot keep up with the growth of ways and means that the mind of man can devise to minimize the tax payment. How important the corporate tax may be in fostering and encouraging the misallocation of resources and undermining the cost consciousness of business executives, we do not know. But that it reduces the incentive to control or cut certain types of costs, can hardly be denied.

The combination of high personal and corporate tax rates, however, also encourages reinvestment of earnings, which, by providing more capital per worker, may lead to lower costs. Many of the more than 13 million shareholders capable of living on their wages, salaries, and other income prefer to avoid receiving dividend income, if through the plowing back of corporate earnings the market value of their holdings rises. Then they are in a position to realize capital gains on which the maximum tax is 25 per cent. Corporations, recognizing this, have learned how to print their own "greenbacks" in the form of stock dividends in lieu of cash dividends. Whether on net balance this situation encourages industrial expansion and therefore lowers product prices is not easily determined. It does mean, however, immobility of capital, since it tends to concentrate expansion more heavily within existing firms and puts a penalty on new enterprises.

HIGH TAXES DEFER INVESTMENT

The corporation income tax, by virtue primarily of its high level, does have a different price lifting effect—although not a cumulative inflationary effect—by means of a process which is not too obvious. This process has been described by Dr. George W. Terborgh in his recent studies.⁶ To understand this point, we must answer these questions: Who pays the corporation income tax? Is it absorbed? Or, is it shifted, and if so, how is it shifted? Does it retard new investment and modernization?

Those who believe the 52 per cent corporation income tax is not shifted but is absorbed by the shareholders, argue that the application of this tax, particularly at the current high rates, inevitably involves a substantial impairment of the incentive to invest and expand and causes a severe drain on the funds available to finance any expansion.

If the present tax rate reduces corporate profits by 52 per cent, it must inevitably have a drastic effect on the volume of retained earnings available for financing expansion. It must also reduce substantially the savings of shareholders from dividend income. Furthermore, since it lowers the expected return from new corporate investment, it reduces not only the supply of funds but the incentive to use them. Pretax corporate profits have averaged about 40 billion dollars from 1955 to 1957 (allowing for correction of over and understatement resulting from inflation and five-year amortization). The tax share has averaged about 22 billion dollars, thus leaving only 18 billion dollars of net profits. If we assume that

the income tax has been wholly absorbed, we must also recognize that in the absence of the tax—other things remaining the same—profits would have averaged 40 billion dollars annually, instead of 18 billion dollars.⁷

A SHIFTED TAX

In contrast with the absorption theorists, many of those who assume that the corporation income tax is shifted tend to view this tax with considerable complacency. They seem to assume that if it does not come out of profits, it must be harmless to corporate investment. This is a dubious conclusion. While the degree to which the corporate income tax is shifted is not known precisely, there is increasing agreement among students that, in the long run, the bulk of it tends to be shifted. But this shifting occurs gradually through the curtailment of production which otherwise would be larger. Thus, the reduced output can be sold at a higher price and in this way the tax is shifted.

The shifted tax limits the supply of output by imposing a barrier to new corporate investment; and since about three-quarters of all investment is done via the corporation, this is of considerable importance. How does this work?

The corporate tax falls on the earnings of the shareholders. This means that to justify new investment, a project must show prospects of yielding a pre-tax return that will leave an after-tax return, when the tax is paid, which is adequate to justify the new investment.

A corporate tax rate of 52 per cent

⁶ For an extended analysis of the incidence of the corporation income tax and an explanation of how it is shifted by deferring new investment, see: George W. Terborgh, *Effect of Corporate Income Tax on Investment* (Washington, D. C.: Machinery and Allied Products Institute, 1959).

⁷ The 22 billion dollar difference is not a final measure of the net loss due to the tax; part of this amount would have been drained into the United States Treasury via the personal income tax on dividends, and the abolition of the corporate tax would have required the imposition of substitute taxes. For calculations and other qualifications, see: George W. Terborgh, *ibid.*

on taxable income is equal to a rate of 108 per cent on the after-tax return required to justify investment. If we assume that the prospective return sufficiently high to induce new investment (always uncertain as to outcome) is 10%, the tax is 10.8 per cent of the investment. The combined rate is, therefore, 20.8 per cent.

What the tax does, then, is to raise the required pretax return of possible new ventures to this rate. This level of required pretax return excludes a wide range of possible investment projects that would be eligible in the absence of the tax, or at a lower tax rate. This limits eligibility to new projects of great urgency—that is, of good prospective earning power. The result is that investments in new business ventures and in the improvement of existing facilities are deferred until their expected pretax return rises to the higher requirement.

As Dr. Terborgh points out:

The main effect of such a high corporate investment threshold is to hold an umbrella over existing productive facilities. For it defers the introduction of new capacity competitive therewith. Old facilities must become more decrepit and inefficient before they are replaceable. Their service lives are extended. The economy drags along in consequence with a productive mechanism of greater average age and with more accumulated deterioration and obsolescence than would obtain in the absence of the tax.

This shielding of existing capacity from new competition permits the sale of its products at higher prices than could otherwise be obtained. It is through these higher prices that the income tax is shifted, in the long run, to the market.

Dr. Terborgh also found that the injurious effects of a shifted tax are related to the corporate tax rate, but they are by no means proportional to

it. He found that the percentage increase in the earning power required to justify new investment becomes very rapid after the tax rate passes 40 per cent. Under certain conditions, a reduction of the rate by 12 percentage points (from 52 per cent to 40 per cent) would yield more than two-fifths of the benefit to be obtained by abolishing the tax entirely. And, it is thus evident that we are in critical territory with a 52 per cent tax rate. A reduction of the tax rate from 52 per cent would lower the corporate new investment threshold.

Thus, whether the tax is absorbed or shifted, it tends to slow down new investment. It tends toward higher prices than would otherwise prevail. It slows down technical advance, modernization, and economic expansion. It penalizes business done via the corporation form relative to other forms of business organization. This all is damaging enough to justify substantial reduction—some would say, the elimination—of the tax, entirely apart from any question of cumulative inflation.

Is the tax inflationary? Not in the sense in which the word "inflation" is used by those who adhere rather strictly to the monetary explanation of inflation. It does generate higher prices than would otherwise prevail; but its effect, while general and pervasive, is not cumulative from year to year as may be the case, according to some analysts, of annual wage increases in excess of national productivity improvements, or in case of persistent deficit spending with the deficit financed through the banks.

CONCLUSIONS

Inflation cannot be explained without major reference to money and credit policies and deficit spending. But apart from deficits, our economy does seem to have an inflationary bias, a matter

discussed by other participants in this volume. High taxes, the tax structure, and the tax system may contribute toward upward price pressures. Tax reform designed to generate more investment funds and to improve risk-taking incentives would lower real costs and prices.

Incentives to discover and adopt so-called "tax loopholes" grow out of the extremely high personal and corporate tax rates. The taxpayer, whether individual or corporate, is increasingly making his business and economic decisions in terms of minimizing his tax burden; this drains energy and ingenuity from constructive economic activity to the negative activities of tax avoidance. Considerable misallocation of human and other resources is a consequence of the high rates. Vast armies of high salaried attorneys, accountants and economists, as well as business executives, devote a prodigious amount of time, energy, and resources to ways and means of minimizing the tax burden.

A significant reduction or elimination of the corporate income tax would not only reduce this misallocation of resources, but would encourage industrial modernization and new investment which, in turn, would lead to lower real prices.

In terms of fighting inflation, however, it is not clear that changes in the tax structure could make a major contribution. Efforts to shield the taxpayer from tax consciousness are not only undemocratic but also reduce public resistance to unlimited government and excessive government spending. Taxes levied in such a way that the taxpayer has a clear conception of the burden of the tax could improve the allocation of resources between the public and the private sectors. Similarly, efforts made to get the taxpayer and the consumer to understand that deficit spending—and at times even a balanced budget—under conditions of high or rising prices is likely to redistribute wealth and income in uncertain and arbitrary ways.

Excise and Sales Taxes as Anti-inflationary Measures

By JOHN F. DUE

ABSTRACT: Sales and excise taxes are in all likelihood typically shifted forward in the form of higher commodity prices. Their anti-inflationary influence arises from their effect in reducing real purchasing power by raising commodity prices relative to factor incomes. Unlike other price increases, this type does not have a spiraling effect because it does not generate additional income. Sales and excises have some relative advantage over income taxes so far as inflation control is concerned. They place a heavier relative burden on persons spending high percentages of their incomes and compel them to reduce consumption. They give some incentive to spend less and save more. In addition some persons may tend to spend the same dollar sum, including tax elements, as before. If persons attempt to maintain their old consumption levels of goods and services, they increase their tax liability by so doing. On the other hand, much of the greater anti-inflationary advantage of the sales and excise taxes will be lost if they generate wage increases. The sales and excise taxes may also offer some limited advantage from the standpoint of production incentives, but this can easily be exaggerated. The principal objections to the sales and excise taxes are equity ones; the levies conform much less closely with accepted standards of equity in taxation than the income tax. Sales and excise taxes, as well as the income tax, are greatly inferior to the expenditure tax as anti-inflationary measures, and the latter is more equitable than the commodity taxes.

*John F. Due, Ph.D., Urbana, Illinois, is Professor of Economics in the University of Illinois. He taught at the University of Utah, 1939-42 and 1945-48; served as Economist, Tax Research Division, United States Treasury, 1942; and as Consultant, Tax Advisory Staff, United States Treasury, 1950-53. He has taught at the University of Illinois since 1948. He is the author of *The Theory of Incidence of Sales Taxation* (1942), *Intermediate Economic Analysis* (1947, 1950, and 1956), *Government Finance* (1954, 1959), *Sales Taxation* (1957), studies on Canadian sales taxation, and articles in professional journals.*

INCREASED reliance upon commodity taxes is often defended on the grounds that they are more effective, per dollar of revenue, in checking inflation than income taxes and are less injurious to production incentives. On the other hand critics of these levies not only question their superiority on both of these bases, but in addition condemn them on equity grounds. Before the arguments are examined, a brief review of terminology is necessary. Commodity levies are grouped into two classes, sales and excise taxes. The former type applies to all or a wide range of commodities; the latter, to particular articles or groups of articles. This terminology is not universal; for example, the National Association of Manufacturers has long supported a levy which it calls a general manufacturers' excise but which is a sales tax in terms of the definitions given above. But to an increasing extent the terminology has become standard. Commodity taxes are also frequently called consumption taxes under the assumption, examined in the next section, that they are shifted forward to consumers and thus are borne in relation to consumption expenditures. In addition to commodity taxes, there is one other major form of consumption tax, namely, the expenditure or spendings tax. This tax applies to total consumption expenditures (less deductions) and is collected, like the income tax, from the individual taxpayer on the basis of returns.

THE SHIFTING OF COMMODITY TAXES

The nature and strength of the case for the use of commodity taxes in checking inflation are conditioned by the extent to which these taxes are shifted forward to consumers in the form of higher prices, or, in other words, the extent to which commodity prices are increased relative to wages and other factor incomes. This question has been

reviewed very extensively in the literature for decades, but there still exists substantial difference of opinion. However, the traditional argument that such taxes tend to shift to the consumer is most widely accepted. In the nonpurely competitive markets, in which such taxes typically apply, direct and immediate price increases are likely to occur in view of usual pricing practices, since all competing firms are subjected to a uniform cost increase. The strong demand typical of inflationary periods facilitates shifting. Inevitably, there are some exceptions, and some downward adjustments in prices of particular factor units may occur. Thus for example an increased tax on wine, by lessening wine consumption, will reduce the demand for land specially suited for wine grape production and lower its rental and sale value. But the exceptions are likely to be minor.

It is sometimes argued that a consumption tax, particularly a sales tax, will reduce the total demand for factors of production and thus lower factor prices rather than bring about increases in commodity prices.¹ However, given the strong demand characteristic of inflationary pressures and usual pricing methods, commodity price increases are much more likely to occur. The argument that any general price increase which occurs cannot be attributed to the tax but to monetary policy which permits such an increase not only involves misplaced emphasis on causal factors in the picture, but is meaningless in an inflationary situation, since if monetary policy were in fact preventing price increases, there would be no need for sales taxes or any other tax increases.

The question may be raised about the possibility of a commodity tax being

¹ See E. R. Rolph, *The Theory of Fiscal Economics* (Berkeley: University of California Press, 1954) Chaps. VI, VII.

anti-inflationary when it directly and immediately raises prices. But this price increase is a once-and-for-all proposition (apart from possible effects on wages discussed in a subsequent section); unlike the usual price increases of an inflationary spiral, it does not give rise to increases in factor incomes and thus does not bring further increases in demand. The tax constitutes a wedge driven between the price paid by consumers and that received by business firms, and thus it absorbs purchasing power, checking further price increases.

SALES AND EXCISE TAXES VS. INCOME TAXES

To what extent are commodity taxes more effective, per dollar of tax revenue, in checking inflation than personal income taxes?² It has frequently been argued that the commodity tax effects are greater. In the first place, the tax places a heavier relative burden than the income tax on those persons who spend high percentages of their incomes. These persons frequently must absorb the tax in reduced consumption since they have little or no savings margin. Secondly, the commodity tax gives some incentive to curtail spending since tax liability can thus be reduced. The income tax has no such effect because the direct and immediate liability is unaffected by the use of the income. The effect of a commodity tax is likely to be much greater if the levy is regarded as temporary than if it is considered to be a permanent element in the tax structure. Thirdly, the relative influ-

ence may be affected by the so-called money illusion. Some persons may spend the same total dollar sum from a given income regardless of prices and thus when prices rise because of a sales tax, their expenditures for consumption, net of tax, fall by the full sum of the tax. Persons whose savings consist entirely of fixed commitments (insurance, and others) will also behave in this fashion. Finally, the commodity taxes differ in one other major respect: if a person attempts to maintain his old consumption level despite the tax, that is, to resist attempts of the government to restrict his consumption, he increases his tax liability by so doing. Thus, for a given tax yield the effectiveness of the consumption tax is greater.

On the other hand, commodity taxes suffer from one major weakness as anti-inflationary measures; since they directly affect the cost of living, they are more likely to generate wage increases than other forms of taxes. With escalator clauses in wage contracts the effect is automatic; even without them, the cost of living increase is certain to generate demands for higher wages. Income taxes may have this effect as well since they reduce take-home pay, but the influence is much less direct and certain. Exclusion of the sales or excise tax element from the cost of living index is likely to meet strong political objections and is questionable on other grounds; even the exclusion might not accomplish the desired ends. Whenever a tax generates wage increases, its effectiveness in checking inflation is largely or entirely lost.

PRODUCTION INCENTIVES AND EQUITY

Maintenance of a high and growing level of output is universally regarded as a desirable feature of the economy, quite apart from its aid in checking inflationary pressures with given levels of total demand. Charges are frequently

² See R. Goode, "Anti-Inflationary Implications of Alternate Forms of Taxation," *American Economic Review*, Vol. 42, No. 2 (May 1952), pp. 147-61; E. C. Brown, "Analysis of Consumption Taxes in Terms of the Theory of Income Distribution," *American Economic Review*, Vol. 40, No. 1 (March 1950), pp. 74-89; R. A. Musgrave, *The Theory of Public Finance* (New York: McGraw-Hill, 1959), pp. 447-52.

made that high progressive income taxes reduce output and development, while sales and excise taxes have much less effect of this type per dollar of revenue. Income taxes, it is maintained, reduce the incentive to work, to develop and expand businesses, and to seek maximum efficiency. Sales taxes, since they are not progressive and do not apply to the portion of income saved, presumably would have less effect. While this argument may have limited merit, several objections must be noted. In the first place, a large part of any difference which may exist must be attributed to the progression of the income tax rather than to the use of the income base, as such, and could be eliminated by altering the progression in the income tax structure. Secondly, to the extent to which persons desire income for purposes of consumption, the commodity taxes may also reduce incentives. Finally, there is little evidence that present income taxes are having serious effects upon incentives.

The primary objection to greater use of sales and excise taxes is based on equity grounds. A sales tax in its usual form tends to be regressive and to place substantial burden on the lower income groups. This effect can be greatly reduced by food exemption, but only at the expense of diverting consumption from other purposes to food and increasing inflationary pressures on the latter, as well as discrimination in favor of persons preferring expensive foods. The effect of the regressive distribution of burden is the concentration of the personal expenditure reduction induced by the tax on the lower and lower-middle income groups, with inequitable burden on those families in these groups whose circumstances require them to spend high percentages of income on consumption. The excise taxes, to the extent to which they reduce consumption of the taxed goods, likewise concen-

trate their effects on the lower income groups since those in higher levels can continue to consume the product despite the tax. Excises are likewise inevitably discriminatory among various persons in terms of their relative preferences for taxed and untaxed goods.

COMMODITY TAXES VS. AN EXPENDITURE TAX

Sales and excise taxes are clearly inferior on bases both of inflation control and equity to an expenditure tax.³ This form of levy would be collected directly from individuals on the basis of returns which would be filed in conjunction with those for income taxes. The tax liability would be based upon total consumption expenditures made during the year, as calculated by subtracting the net increase in the person's wealth (the net amount saved during the year) from income earned. Certain expenditures, such as those for medical purposes, education, and others, would presumably be deductible; as with the income tax, a standard exemption would be permitted as well for each member of the family. The taxable expenditures could then be subjected to highly progressive rates, the exact degree depending on the desired anti-inflationary pressure. Rates could exceed 100 per cent; if for example, in a period of severe inflation, a 500 per cent rate were applied to expenditures in excess of \$20,000, the expenditure by a person of an additional dollar would increase his tax payments by \$5. Such a levy would not only give much greater incentive to lessen consumption than either commodity taxes or the income tax, but would also be more equitable than commodity taxes because of the personal exemptions. The sales tax cannot approach the expenditure tax in its ability to discourage

³ See N. Kaldor, *An Expenditure Tax* (London: George Allen and Unwin, 1955).

spending; it is less equitable, in terms of usual standards, and it offers greater danger of giving rise to wage increases.

SALES VS. EXCISE TAXES

If commodity taxes are to be employed for purposes of inflation control, the choice between a sales tax and a group of excise taxes is difficult to make. The broader scope of the sales tax increases its potential influence at rates which may be regarded as acceptable. The sales tax is less discriminatory on the basis of personal preferences, but it is more regressive, a consideration which in practice may limit the politically tolerable rate to one far lower than that acceptable on excises. The sales tax avoids the inevitable effect of excises in shifting consumption from some goods to others and thus increasing the inflationary pressures on the latter.

This shifting effect is desirable in one type of situation, namely, when the demand is transferred from very scarce items to ones much less scarce. Such a tax may be designated as a demand shifting excise and distinguished from the form simply intended to absorb purchasing power (demand absorbing excise). The former type is more effective to the extent to which the demand is elastic, the latter to the extent to which the demand is inelastic. The absorbing type must be employed on items of widespread use and thus may be as regressive as the sales tax itself. In contrast, the demand shifting type may have a much more acceptable burden pattern by income group.

MODIFICATIONS IN PRESENT COMMODITY TAXES

The federal government now obtains about 16 per cent of its tax revenues from excises—liquor and tobacco levies accounting for about half of this total—while the states gain about 23 per cent of tax revenues from sales taxes and 8

per cent from liquor and tobacco taxes. Could changes in these levies aid economic stability and growth? So far as the federal excises are concerned, they are now largely confined to consumption goods; while some may be criticized on equity grounds as discriminatory against persons with high preferences for taxed items and others as regressive, most of them likely have little adverse effect on the economy. One particular tax, however, is open to serious criticism, namely, that on passenger transportation. This tax, by encouraging travel by private automobile, adds to highway congestion. At the same time it makes the task of commercial passenger carriers in continuing to supply adequate service more difficult and the service more expensive, per passenger, because of reduced volume. Repeal of this tax, which was originally imposed to check passenger travel in World War II, is long overdue.

The state sales taxes have one feature which may be regarded as undesirable. Most of them apply to capital equipment as well as to consumption goods. As a consequence they artificially increase the cost of new investment and may have some influence in slowing down the rate of economic growth. From a short-run standpoint, however, the investment restriction aids in the checking of inflation.

CONCLUSIONS

The substitution of a federal general sales tax or a much more extensive system of excises for a portion of the present income tax burden would probably do little good from the standpoint of inflation control. The difference in production incentive effects of the change would probably not be very great, and such advantages could largely be gained by alteration in the rate structure of the income tax with much less loss of equity. While greater use of commod-

ity taxes might appear to have somewhat greater anti-inflationary effect, per dollar of revenue, much of the advantage would be lost if the tax were regarded as permanent, and all of the gain might be more than offset by wage increases generated by the higher cost of living. A more extensive and heavier excise system would increase the discrimination inherent in the present excise system; a general levy would be more burdensome on the lower income groups and would result in duplication with the major tax source of the states, the retail sales tax. A basic dilemma is also encountered on the question of the choice of types of sales tax. One at the retail level, probably on the whole the most acceptable form, involves collection from large numbers of firms and would directly duplicate the state levies. But a sales tax at the manufacturing level gives rise to substantial pyramiding of tax as merchants apply markup percentages to purchase prices which include tax. This would create serious problems of determining a suitable price figure to which the tax rate would be applied in fields in which some manufacturers have assumed wholesaling functions and sell directly to retailers

or consumers, while competing firms have not.

On the whole, continued primary reliance on income taxation is to be preferred to increased use of excises or a federal sales tax on the basis of considerations of equity, inflation control, and economic development. The income tax conforms more closely to accepted standards of equity and probably has relatively little greater adverse production incentive effects than the commodity taxes. While its direct anti-inflationary effectiveness might appear to be less than that of consumption levies, this advantage is largely offset by the greater tendency of the latter to generate wage increases. The demand-shifting type of excise, however, may play a useful role in an inflationary situation in which some nonnecessary items are very scarce. In contrast to the limitations of commodity taxes, a well designed expenditure tax is without question far superior to an income tax as an anti-inflationary measure and avoids the inequities of commodity taxes. If further inflationary tendencies continue, this type of levy warrants much more attention than it has received in the past.

The Payroll Taxes and Social Security

By PAUL G. CRAIG

ABSTRACT: The social security system encompasses a broad group of compulsory public and negotiated private quasi insurances which protect workers against the economic risks of death, old age, disability, and unemployment. The various parts of this system cover from 25 per cent to 95 per cent of all workers. And the combined revenues of the public and private programs are around 25 billion dollars per year. There are two approaches to an analysis of the economic stability effects of this system, a cash flows approach and a tax incidence approach. Analyzed on a cash flows basis, social security has had very slight influence on economic stability. Analyzed from an incidence point of view, social security programs have been slightly inflationary. But because of the similarity of the propensities to consume in the various income strata, this influence is negligible. Hopes that alternative methods of financing might make the social security system into an effective instrument of countercyclical fiscal policy are largely groundless for several reasons. The institutional complexity of the system, the basic purposes which it serves, and the size of the federal budget all preclude significant changes in financing.

*Paul G. Craig, Ph.D., Watertown, Massachusetts, Associate Professor of Economics, The Ohio State University, is a Ford Foundation Faculty Fellow at Harvard University for 1959-60. He served as Economist in the Division of Research and Statistics, The Ohio Bureau of Unemployment Compensation in 1953. Since 1956 he has served part time as Economist in the Bureau of Business Research, The Ohio State University, and presently he is a member of the visiting faculty of the School of Logistics, Air Force Institute of Technology. Dr. Craig is co-author with Edison L. Bowers and William Papier of *Financing Unemployment Compensation* (1956). He has contributed articles to *The Encyclopedia Britannica Yearbook* and various professional journals. His principal areas of study are social security and business fluctuations.*

WHAT do payroll taxes and social security have to do with inflation and economic stability? To answer this question one must first define what is meant by social security and payroll taxes. This immediately leads to a problem of scope. Not all worker benefits which one might logically call social security are financed by payroll taxes. Should all of the benefits be considered or only those financed by payroll taxes? For the purposes of this paper, we shall determine our scope in terms of benefits rather than the more narrow dimensions of tax-financed benefits.

Social security means different things to different people. To the man on the street it usually means one specific thing, the federal Old Age, Survivors, and Disability Insurance (OASDI). This is the program which requires a worker to have a "social security" card and a "social security" number. It is financed by a combination of a payroll tax on employers and withholdings from the earnings of workers. It is a compulsory public insurance which provides some security against the economic insecurities associated with old age, premature death, and disability; hence the appropriate title, social security.

To some people social security has a broader meaning. It includes all compulsory public programs of a quasi-insurance nature which protect workers against the economic risks of death, old age, disability, and unemployment. This definition encompasses OASDI; the state unemployment compensation systems; the state workmen's compensation laws covering job-connected disability; and the special programs covering similar risks for railroad workers, merchant seamen and the employees of the federal, state, and local governments.

It is increasingly common, however, to define social security by including all of these public programs and the private ones which supplement and/or extend

them. Business firms now provide large numbers of workers with group life insurance, hospitalization and medical benefits, temporary disability or sick leave pay, old-age pensions, and supplemental unemployment benefits. These private employee benefits are similar in intent and effect to their public counterparts and are distinguished from them by the facts that they are not compulsory and not tax financed. Together the public and private benefit programs constitute the rather unique American social security system.

MAGNITUDE OF SOCIAL SECURITY

This broadly defined social security system looms large in our economy. Its effects on individuals, business, and society are far reaching. The various public programs cover from 65 per cent to 95 per cent of all workers. The private benefits, excluding the relatively new supplemental unemployment benefits, cover from 25 per cent to 60 per cent of all workers. In the single year of 1957, the most recent year for which complete data are available, the public social security activities had receipts from all sources of 14.5 billion dollars and paid benefits of 12.6 billion dollars.¹ The private programs had estimated 1957 receipts of 9.9 billion dollars and expenditures of 5.6 billion dollars.² Thus in one year the whole social security system had revenues of 24.4 billion dollars and expenditures of 18.2 billion dollars. The revenues were slightly more than 10 per cent of the total wage and salary bill of the United States economy, and the benefits paid

¹ U. S. Department of Health, Education, and Welfare, *Social Security Bulletin, Annual Statistical Supplement* (Washington, D. C.: United States Printing Office, 1957), p. 14.

² Alfred M. Skolnik and Joseph Zisman, "Growth in Employee-Benefit Plans, 1954-57," *Social Security Bulletin*, Vol. 22, No. 3 (March 1959), p. 10.

were over 7.5 per cent of total wages and salaries.

Although a social security system of such magnitude certainly has many effects, we are concerned here only with the effects on economic stability and the problems of inflation and deflation. There are two approaches to analysis of this aspect of social security. One attempts to answer first the incidence question, that is, who really pays for the benefits—workers, through lower money wages than they otherwise would have received; property owners, through lower profits, rents, and interest receipts; or consumers, through higher prices. This approach then proceeds to analyze the stability effects of the incidence conclusions. The other approach ignores the incidence question and concentrates on the aggregate flow of spendable income as it is affected by social security. This approach is justified in part at least by the fact that the marginal propensities to consume and save are quite similar for different income groups.

SOCIAL SECURITY CASH FLOWS

Regardless of who ultimately bears the cost of social security, the taxes, contributions, and insurance premiums which finance the system are a subtraction from someone's current income. They therefore reduce someone's ability to spend. Likewise, social security benefits are an addition to someone's current income and increase someone's ability to spend. If, during each accounting period, the receipts of the system equaled its expenditures, the system would make no net change in aggregate spendable income. True, there would be transfers of spending power within the economy but no change in the volume of spending power. Assuming that the transfer process did not influence personal or business behavior in a destabilizing way, such a social security

system would be neutral in regard to economic stability.

The social security system can be classified into three basic financing groups—nonreserve accumulating, increasing reserve accumulating, and variable reserve. Each class has different stability effects and must be analyzed separately.

Disability, medical, retirement, and death benefits

Disability and medical benefits are financed on a pay-as-you-go basis. For each accounting period, the payments into the system are about equal to disbursements. Except for small actuarial reserves to meet random variations in annual costs, these programs are non-reserve accumulating and have no significant stability effects.

Retirement and death benefits programs are increasing reserve accumulating until they reach maturity, that is until the number of persons in the system and the average age of those persons both stabilize. Since the labor force is growing, the average age of the population is changing, and retirement and death benefits programs are being extended to an increasing share of the population, these programs will continue for some time to be increasing reserve accumulating. Thus, this part of the social security system extracts from the income stream more money than it puts back. In the twenty-two years that OASDI has been in effect it has accumulated reserves of 21.4 billion dollars.³ It has, therefore, acted as a form of forced saving which has tended to depress or restrain the economy. Since for most of this time, the economy has experienced gradual inflation, the reserve accumulation has had a desirable stabilizing influence. Without it the inflation probably would have been

³ *Social Security Bulletin*, Vol. 22, No. 5 (May 1959), p. 27.

greater. Private pension programs are estimated to have 34.8 billion dollars in reserves and may be construed to have similar effects on the economy.⁴

The combined reserves of the public and private retirement and death benefit funds are equal to 1.8 per cent of the total wages and salaries paid in the United States in the last twenty-two years. Such a rate of forced savings has a considerable restraining influence on our economy. One might raise the point that these reserves are not idle cash hoards. They have been invested and thereby have found their way back into the spending stream. But the investments, or expenditures, which they financed certainly would have taken place even in the absence of these savings. For example, almost the entire OASDI reserve and a substantial part of the private pension funds are invested in the federal debt. This debt was incurred largely to finance World War II and the Korean conflict. Had the retirement funds not been available for loan, the government would have borrowed the money elsewhere, largely from banks. Such bank borrowing would have added to inflation, whereas the borrowing of pension reserves did not.

Unemployment benefits

The unemployment compensation system is based on variable reserves. These reserves are quite substantial, but they are no larger now than at the end of World War II. Total public unemployment compensation reserves were 6.6 billion dollars in December 1944 and 6.4 billion dollars in March 1959.⁵

⁴ Skolnick and Zisman, *op. cit.* (note 2 *supra*), p. 12.

⁵ *Social Security Bulletin, Annual Statistical Supplement* (Washington, D. C.: United States Printing Office, 1957), p. 17; and U. S. Department of Labor, *The Labor Market and Employment Security* (Washington, D. C.: United States Printing Office, May 1959), p. 57.

Over fifteen postwar years, involving three recessions, the system has been in approximate fiscal balance. For shorter time periods, however, the system has not been in fiscal balance. Aggregate state reserves increased by about 2 billion dollars in the four years 1944-48, thereby reducing the flow of spendable incomes in those inflationary years. In 1949 reserves declined 740 million dollars, increasing the flow of purchasing power during the recession. From December 1949 to December 1953 reserves rose by 1,777 million dollars, helping to curb spending power during the Korean inflation. Reserves fell 808 million dollars during the recession year of 1954. In the three following years reserves grew by 361 million dollars. Then in the fifteen months from December 1957 through March 1959, reserves declined 2,685 million dollars, by far the sharpest rate of decline since unemployment compensation began.⁶

These fluctuations in unemployment compensation reserves are stabilizing in nature. However, when the changes in reserves are compared to the total flow of wage and salary income, it becomes obvious that the stabilizing effect of unemployment compensation financing is quite negligible. In none of the time periods described above was the change in reserves as high as 1 per cent of the wage and salary income for the period. By far the greatest stabilizing influence came in the fifteen months preceding March 1959, and here the decline in reserves was only 0.9 per cent of the wage and salary income for the period.

The conclusion to be drawn from an analysis of the social security system relative to spendable income flows is that the system has only a slight effect on economic stability. The bulk of this

⁶ All of the data on unemployment compensation reserves are taken from the *Social Security Bulletin, Annual Statistical Supplement*, 1957, p. 17.

effect may be attributed to the reserve accumulation process in OASDI and private pension funds. As a whole, social security cash flows have been slightly deflationary. During a period of inflation this has been salutary. If we were to again be faced with secular deflation, the system's financing could be cause for concern.

PAYROLL TAX INCIDENCE

Turning from the cash flows to an incidence approach, the analysis is more complex and uncertain. Over the years a majority of writers on incidence have concluded that payroll taxes are ultimately borne by workers. This was especially true of those writing before World War II and was a basic doctrine of neo-classical economics. H. G. Brown's 1922 article was a classic statement of the position. "An insurance premium . . . imposed upon employers . . . according to the number and wages of workers hired, will not raise prices in general and must fall upon wage-earners and upon wage-earners alone."⁷

A few writers such as A. M. Rosenson have concluded to the contrary that "Labor as such will escape the incidence of the [payroll] tax almost entirely."⁸ Consumers and employers presumably will share the tax according to the degree of monopoly in the various industries. Almost all of these earlier conclusions, however, are the result of deductive reasoning, little empirical work being possible. Recent improvements in data, although inadequate to settle the issue, have shaken the certainty of current students of the problem. R. A. Musgrave, certainly one of

the most capable and empirical students of public finance, concludes that "the search for quantitative estimates of tax incidence leads the explorer through a wasteland of muddled concepts, inadequate theory, and lack of data."⁹ Professor Carl Shoup, in discussing research to answer the incidence question and the public policy issues involved concludes that "... the difficulties are indeed so formidable that the product would not be of material assistance with respect to deciding the broad question of policy"¹⁰

Most recent students have come to agree with L. H. Kimmel who says, "We conclude . . . that no general rule can be laid down as to who ultimately bears the pay-roll taxes imposed on employers."¹¹ In a dynamic economy which is continuously in a process of change, the effects of payroll taxes are so blurred that any causal sequence is all but impossible to establish.

Labor's share of income

We know that labor's share, including wages and fringes, of total income has increased in the last thirty years, both within homogeneous sectors of the economy and in the economy as a whole.¹² But in assessing the role played

⁹ R. A. Musgrave, J. J. Carroll, L. D. Cook, and L. Frane, "Distribution of Tax Payments by Income Groups: A Case Study for 1948," *National Tax Journal*, Vol. 4, No. 1 (March 1951), p. 1.

¹⁰ Carl Shoup, *The Prospects for A Study of the Economic Effects of Payroll Taxes* (Washington: Social Science Research Council, 1941), p. 2.

¹¹ Lewis H. Kimmel, *Taxes and Economic Incentives* (Washington: The Brookings Institution, 1950), p. 181.

¹² Research by the author, using the National Income data of the United States Department of Commerce, indicates that the compensation of employees, including fringe benefits and social security contributions, increased from 58.7 per cent of total national income in 1929 to 70.7 per cent in 1956. Much of this increase is attributable to struc-

⁷ Harry Gunnison Brown, "The Incidence of Compulsory Insurance of Workmen," *The Journal of Political Economy*, Vol. 30, No. 1 (February 1922), p. 70.

⁸ Alex Moses Rosenson, "Monetary Effects of Wartime Social Security Taxes," *The Journal of Political Economy*, Vol. 40, No. 6 (December 1942), p. 892.

by social security benefits it must be recognized that they are only a small part of total labor gains. Furthermore, collective bargaining gains only partly explain labor's increased share of national income. Bargaining has taken place during a period of broad government intervention in the economy and significant changes in the structure of the economy. Federal housing and tax policies have reduced the rent share of total income. Monetary policies have reduced the interest share. The decline in agriculture, a decline in the relative importance of business proprietorships, the relative increase in government in employment, and the relative increase in manufacturing and service industries all have contributed to a decline in the property share and rise in the labor share in national income. We may conclude, therefore, that some part of social security costs have been borne by employers, but exactly what part is uncertain. We cannot conclude that all of social security costs were borne by employers because we do not know what would have happened to money wages and other benefits in the absence of social security.

Productivity and prices

We know also that in the postwar years, especially since Korea, labor's

tural changes in the economy such as the decline in agriculture, in which labor payments are a small share of output, and a rise in manufacturing and service industries, in which wages are a large share of output. However, even after correcting the data to allow for these structural changes, employee compensation increased to 64.2 per cent of national income by 1956. Out of seventeen major manufacturing industry groups studied, labor's share of output increased in 12. In the Transportation Equipment industry, for example, labor's share of output increased from 83.8 per cent in 1929 to 89.6 per cent in 1956. In the Metal and Metal Products industries labor's share increased from 72.7 per cent to 78.7 per cent.

compensation, wages plus fringes, has increased faster than productivity. From 1947 to 1956 man-hour productivity in the private nonagricultural sector of the economy increased 26.1 per cent and average money wages per hour rose by 61.4 per cent. Until 1950 productivity and hourly wages increased more or less together but from 1950 to 1956, the productivity index (1947 = 100) increased by 12.8 percentage points while the hourly wage index rose 42.9 percentage points. Throughout this period prices increased. The logical conclusion is that part of labor's gains, including social security, was paid for by consumers.¹³ The summary conclusion from incidence analysis is that, although we cannot separate social security benefits from other labor gains, their cost obviously is diffused among workers, employers, and consumers, with the two latter groups carrying most of the load. What does this mean in terms of the stability effects of social security?

The effects of incidence

That part of social security cost borne by workers serves either to transfer income from one group of workers to another; or, in the case of individual workers, to transfer the effective receipt of income from one point of time to another. Since such transfers are mainly horizontal, that is, not up and down among income strata, they have little influence on aggregate spending. To the extent that the social security system has accumulated cash balances, the effect has been to increase worker savings. This is deflationary.

To the extent that employers have borne the cost of social security, there has been some transfer of income from

¹³ U. S. Department of Labor, Bureau of Labor Statistics, "Productivity, Earnings, Costs and Prices in the Private Non-Agricultural Sector of the Economy, 1947-1956," May 13, 1957. Mimeographed.

upper income property owners to lower- and middle-income wage and salary workers. However, available evidence suggests that the marginal propensities to consume are very similar at different income levels, with only slightly higher propensities among lower income groups. When we recognize that part of the income transferred to the lower income groups goes into forced savings, we must conclude that the relative balance between the flows of spending and saving is little affected by this part of incidence. The stability effects are negligible.

Finally, that part of social security paid for by consumers through higher prices is obviously inflationary. But, as was pointed out earlier, social security benefits are a relatively small part of aggregate labor gains, and their share of any inflationary pressures stemming from labor-cost increases must be correspondingly small.

Social security programs have brought considerable economic stability into the lives of individual persons. But, whether analyzed on a cash flows or an incidence basis, they have had little influence on the stability of the economy as a whole. Only unemployment benefits have countercyclical financing effects, and even here the influence is so minor as to be washed away in the broader flow of events in business fluctuations.

ALTERNATIVE FINANCING

Over the years there has always been some interest in proposals to finance social security out of the general revenue fund rather than through specific ear-marked payroll taxes. Some exponents of such a change favor it as a means of redistributing income, arguing that general revenue financing would place a larger share of social security costs on upper income groups through

the effects of the progressive income tax. More commonly, however, general revenue financing has been proposed as an instrument of countercyclical finance. Present payroll taxes continue to take in large tax receipts even in recession, consequently social security cash flows have little stabilizing effect. Supposedly, if social security were financed out of general revenues, the receipts of the system could be varied in a countercyclical way, making large contributions out of general revenues into social security funds during prosperity and little or no contribution in recession.

There are many objections to general revenue financing and postwar developments have strengthened most of them. The social security system is not primarily a stability device. It is a program of compulsory insurance to bring basic economic security into the lives of individuals. To perform this function the actuarial soundness of its finances must be secured, and this requires that the finances be relatively free from transient political pressures. Furthermore, to protect the system from abuse and to preserve the dignity of the participants, the program must be viewed as one of worker rights not charity. Payroll taxes and employee contributions serve these purposes better than general revenue fund appropriations.

In the last twenty-five years big government has come to stay. This has brought with it two strong new objections to general revenue financing for social security. First, the general revenue budget is already large enough to allow adequate room for countercyclical fiscal policy. The federal budget is around 15 to 16 per cent of the Gross National Product and shows little evidence of declining. There is no need to add social security into the budget just to make it large enough for pur-

A Federal Tax Program to Promote Economic Stability and Growth

By LEWIS H. KIMMEL

ABSTRACT: Federal tax policy is no longer based on the assumption that an annually balanced budget is essential. Increasing taxes to maintain budgetary balance during a recession or depression would be construed as a perverse approach to fiscal policy. The built-in stabilizing features of the tax structure are regarded favorably by economists, members of Congress, and government officials. Federal tax policy can be helpful in preventing or controlling inflation. Not all inflationary situations can be controlled by increases in taxes; marked rises in taxes in themselves have dislocating effects. Sharp changes in federal expenditures have been more important as an inflation-making factor than postwar deficits. The bases for the personal and corporate income taxes should be strengthened. Inclusion of sources of income now excluded and the elimination of various forms of favored treatment would permit appreciable reductions in tax rates.

*Lewis H. Kimmel, Ph.D., Washington, D. C., is a member of the senior research staff of The Brookings Institution. He is the author of *Governmental Costs and Tax Levels* (1948), *Taxes and Economic Incentives* (1950), *Share Ownership in the United States* (1952), and *Federal Budget and Fiscal Policy 1789-1958* (1959). He is currently engaged in a study of the evolution of state and local finance.*

THE federal tax system is widely criticized and occasionally commended. Critics hold that the tendency to narrow or contract our leading tax bases is an especially grave defect. A few have asserted that the present tax system is not a "system" in any meaningful sense. On the other hand, those who feel that the federal tax system is entitled to at least modest commendation stress its productivity. Rather than being inadequate, an enormous flow of revenues has been maintained.

The position here taken is an intermediate one.¹ Excluding the fiscal year 1959, federal postwar budgets in the aggregate came close to balance and on a cash basis there was a surplus.² In the circumstances, any charge of fiscal inadequacy would be meaningless. Considering the postwar record, it would be difficult to sustain the claim that federal taxes have seriously retarded economic growth. At the same time, a realistic appraisal suggests that improvements are desirable.

THE NEW FOCUS OF TAX AND BUDGET POLICY

Throughout most of our history federal tax policy was predicated on the assumption that an annually balanced budget was essential, except in time of war. The goal of tax policy as recently as the early 1930's was a volume of revenues that would restore a balanced budget. In the depth of the depression, rates for existing taxes were increased, additional taxes were enacted, and a

broadly based sales tax was strongly urged—in the hope that the budget could be brought into balance. Tax and other revenues equal to expenditures were thought to be a necessity if confidence was to be regained and private investment flows restored.

The change in outlook in recent decades is well illustrated by the "economic principles" formulated by the Joint Economic Committee in 1956. The first principle is:

Federal tax policy should recognize that the level of tax revenues in relation to the amount of government expenditures has an important bearing on the level of economic activity. This would tend to result in federal surpluses and debt retirement during prosperous and boom periods and deficits during recessions and depressions.

The committee believed that:

increasing taxes to maintain federal revenue in balance with expenditures during a recession is a force toward deepening the recession. By the same token, maintaining a budget balance by reducing tax rates when a budget surplus emerges from inflationary expansion of income could serve to reinforce inflationary pressures.³

The second principle is: "Tax policy should improve the automatic stabilization potential built into the federal revenue system." The committee expressed its satisfaction with the "built-in features" of the present tax structure, though it was recognized that automatic stabilization features cannot fully counteract fluctuations in economic activity. Automatic or built-in stabilizers are elements of governmental revenues and expenditures that operate to increase or decrease output or spending power. They are set in motion by a decline or rise in economic activity without the necessity of formal action for the pur-

¹ The views expressed in this article are those of the author and are not necessarily those of the other staff members or the administrative officers of The Brookings Institution.

² Budget receipts for the twelve fiscal years 1947-58 combined covered all but 12.6 billion dollars or 1.9 per cent of budget expenditures. On a cash basis, receipts from the public—general, special, and trust funds—exceeded payments to the public by almost 19 billion dollars, or 2.6 per cent.

³ *Federal Tax Policy for Economic Growth and Stability*, Senate Report 1310, 84th Congress, 2d Session (Washington, D. C.: United States Printing Office, 1956), pp. 2-3.

pose of effecting such increases or decreases. In the committee's view, increasing the capacity of the tax system to provide automatic stabilization is an important factor in federal tax policy. Enhancing the built-in flexibility of the revenue system would require mainly strengthening the individual and corporate income taxes.⁴

One who approves the present built-in features of the tax structure, together with improvement of the automatic stabilization potential, cannot logically favor an annually balanced budget. Perhaps less apparent is the absence of any conflict between acceptance of automatic stabilization as a guide to policy and a balanced budget over a longer period such as a complete business cycle. Adoption of automatic stabilization as a guide to policy does not mean that the balanced budget concept has ceased to be meaningful. What it does mean is that approval of automatic stabilization as a leading component of fiscal policy cannot be harmonized with the annually balanced budget philosophy.

The turn-about in tax and budget policy is little short of amazing. A concerted effort to increase tax revenues during a serious recession, in the expectation that a balanced budget and fiscal soundness would thereby be maintained, would be construed as a perverse approach to fiscal policy. The change in our thinking is illustrated by pronouncements concerning the income tax. Until the mid-1930's the tendency of income tax revenues to decline more than proportionately with changes in national income was regarded as a principal disadvantage of this form of taxation. With the more recent emphasis on automatic stabilization, this disadvantage has become a virtue.

Most economists hold that if tax and budget policy are to make their maxi-

mum contribution to economic stability, discretionary action may be needed as a supplement to the built-in stabilizers. A tax reduction, it is said, is likely to be more effective than an increase in public works or other expenditures. Under the withholding system, a tax reduction will be reflected promptly in increased disposable income. Moreover, it is possible to time the termination of the reduction in accordance with the requirements of the economy. In contrast, a public works program cannot be started at full speed when it is approved, and there is always a possibility that the impact on consumer buying power will be strongest when it is no longer required.

Under our system of divided powers the implementation of discretionary fiscal measures is not an easy matter. Partly for this reason, it has been suggested that some form of formula flexibility might provide an appropriate supplement to the built-in stabilizers. Under formula flexibility a law might be enacted providing that the first-bracket rate for the personal income tax be reduced from 20 per cent to 15 or 10 per cent and withholding rates lowered proportionately, if unemployment exceeded 4.5 or 5 millions for a period of say 3 months. Formula flexibility would be a sort of half-way measure between automatic stabilization in a strict sense and discretionary action.⁵

FEDERAL TAXES AND INFLATION

A reasonably stable price level is widely recognized as a necessary condition for economic stability and orderly economic progress. Is the federal tax system helpful in controlling inflation? Do federal taxes in themselves contribute to inflation?

⁵ A decade ago a committee of the American Economic Association recommended formula flexibility as a subject for further exploration. *American Economic Review*, Vol. 39 (1949), p. 1268.

⁴ *Ibid.*, pp. 4-5.

Federal and other taxes are helpful in controlling inflation. This conclusion rests upon a simple theory. Inflationary pressures arise because of market demands for goods and services in excess of supplies available at prevailing prices. To prevent or eliminate inflationary pressures, the combined demands of consumers, purchasers of capital goods, and government must be held or reduced to an appropriate level. This goal may be achieved, it is reasoned, by setting tax rates at a point where private expenditures for consumer and capital goods will be in balance with available supplies at constant prices.⁶

To anyone familiar with postwar financial and economic developments, it is obvious that the large deficits of the war years, the enormous backlog of unfilled needs at the end of the war, and the large volume of liquid assets in the hands of consumers contributed importantly to the postwar inflation. What is less well understood is that postwar federal deficits in themselves have not been a dominant reason for inflation.⁷ Sharp changes in federal expenditures have been far more important. It is not denied that a more vigorous tax policy might have had a dampening effect on aggregate demand and pressures on the price structure. On theoretical grounds, it can be argued that a sufficiently high structure of tax rates can halt inflation. But in practice the dislocating effects that would be produced cannot be ignored.⁸

⁶ Lester Chandler, "Taxation as an Instrument for Inflation Control," in *The Limits of Taxable Capacity* (Princeton, N. J.: Tax Institute, 1953), pp. 97 ff. An alternative method would be to reduce governmental expenditures.

⁷ Federal cash receipts from the public for the period 1947-58, as pointed out previously, exceeded payments to the public by almost 19 billion dollars.

⁸ "Taxes reduce purchasing power, but not homogeneously. Therefore they have destabilizing effects of their own." Kenyon E. Poole, "Tax Policy's Effect on Inflation," in

The point we wish to emphasize is that at times pressures throughout the economy may become so strong that inflationary tendencies are not controllable by any tax policy that would be acceptable. An especially troublesome problem arises when there are sharp changes in the direction of demand; for example, in situations such as the Korean outbreak. In the absence of rigid price controls, increased demands for goods in excess of available supplies are inevitably reflected in some rises in prices. Holding the price level constant assumes a forced reduction in other prices. When the economy is buoyant, this may prove to be virtually impossible.

The weakness of the position that a vigorous tax policy, which will yield substantial surpluses when combined demands emanating from the private and public sectors are unusually strong, can prevent inflation was demonstrated in 1948. At the beginning of the year inflationary pressures were recognized as a "major threat to the stability of the American economy." A large cash budget surplus was in the making, but action to reduce the size of the surplus was not deemed desirable. Because of the strength of other demands, deferral of public works—federal, state, and local—was recommended wherever feasible.⁹ When the accounts for the fiscal year ended June 30, 1948, were available, the budget surplus was 8.4 billion dollars and the cash surplus was 8.8 billion dollars. Revenues exceeded payments by approximately one fourth.¹⁰

Proceedings, Fiftieth Annual Conference on Taxation, 1957 (Harrisburg, Pa.: National Tax Association, 1958), pp. 359-60.

⁹ *Economic Report of the President*, Jan. 14, 1958 (Washington, D. C.: United States Printing Office, 1958), pp. 47, 98.

¹⁰ *Budget of the United States Government for the Fiscal Year Ending June 30, 1950* (Washington, D. C.: United States Printing Office, 1949), pp. A 4, A 123.

To those who held that inflation was principally a consequence of deficit financing, continuation of inflation when the government was running a large surplus posed a dilemma. The situation was well summarized in a report of the Joint Economic Committee. The inflationary condition, the Republican majority stated, "is due to our attempt to accomplish more than is possible at our present capacity for production." Liberal credit policies and low interest rates facilitated the expansion of the many large programs the people and the government were carrying on.

[The] attempt to carry them all on at once, with very little restraint in the field of consumer spending and liberal credit policies, is the basic reason for inflation, which otherwise could hardly coincide with a large Government surplus.¹¹

In considering the second question—whether federal taxes may contribute to inflation—an economic budget with the federal accounts in balance will be assumed. Opinions concerning the incidence and price effects of leading taxes often differ, but there is universal agreement that all taxes involve the appropriation by government of a portion of the annual income that otherwise would be available for consumer expenditures and private capital expansion.¹² All taxes have what may be called a generalized incidence. An obvious corollary is that some price effects attributable to taxes are inevitable when government requirements are as large as they have been in recent decades.

¹¹ Senate Report 1358, 80th Congress, 2d Session (Washington, D. C.: United States Printing Office, 1948), pp. 3-4.

¹² Inheritance and other death duties may appear to be an exception. To the extent that these taxes are covered by liquidation of assets, there is "dissaving" which in most circumstances merely means a somewhat lower volume of net saving.

The price level is definitely higher because of federal taxes. Manufacturers' excises are largely reflected in higher prices, and the retailers' excises are added specifically to the base price. That is, the incidence of these taxes is mainly on the consumer. To an indeterminate degree prices are higher by reason of customs duties. Although levies on imports account for only a minor portion of federal revenues, the cost-of-living and regressive arguments that were long prominent features of tariff debates have not lost all meaning.

The situation concerning the corporate income tax is less clear. Ever since the *Galveston* decision of 1922, regulatory commissions have taken the position that the fair rate of return to which utilities are entitled is an "after income-tax" return.¹³ Numerous executives of large manufacturing and other companies, especially in administered price industries, hold that this tax is taken into account in determining price schedules and is reflected in price. The use of a target return on capital investment in setting prices lends support to this view.¹⁴ There is of course nothing inconsistent between the view that the short-run incidence of the corporate income tax is on the share owner and the idea that over a period of time a substantial portion of this tax may be reflected in price.

It is almost universally assumed that the incidence of the personal income tax is on the taxpayer—that is, the tax is

¹³ *Galveston Electric Co. v. City of Galveston*, 258 U. S. 388.

¹⁴ A. D. H. Kaplan, Joel B. Dirlam, and Robert F. Lanzillotti, *Pricing in Big Business* (Washington, D. C.: The Brookings Institution, 1958), pp. 8, 128, 130 ff. "Target return on investment was probably the most commonly stressed of company pricing goals." P. 130. See also the author's *Taxes and Economic Incentives* (Washington, D. C.: The Brookings Institution, 1950), pp. 27-31.

not shifted. Nevertheless, there is reason to believe that high rates for this tax may contribute to higher prices. The emphasis on take-home pay in wage negotiations, particularly in the early postwar years, lends support to this view. Though the level of wages may be somewhat higher because of personal income taxes, it does not necessarily follow that a substantial portion of the tax is shifted. To the extent that personal income taxes have influenced wage decisions, they have also affected costs and the level of prices. The end result is probably some redistribution of the burden of personal income taxes, rather than the shifting of an appreciable part of the burden.

There is nothing inconsistent between the two principal conclusions reached in this section: (1) that federal tax policy is a valuable aid in the control of inflation; and (2) that federal taxes contribute to a higher level of prices. The first conclusion follows logically from an appraisal from the demand side, whereas the second was reached from the cost or supply side. With the economy in balance and inflationary pressures completely absent, the second conclusion would still be valid.

TAX POLICY AND TAX BASES

A federal tax system that will facilitate economic growth is a principal goal of fiscal policy.¹⁵ A fundamental requirement if the federal tax structure is to be improved is a broadening of leading tax bases. The federal personal income tax is imposed on a base equal to less than one half of the income of

the American people.¹⁶ Underreporting and evasion account for part of the difference between estimated personal income and total income reported on tax returns. Thus, there is reason to believe that entrepreneurial income from farming is seriously underreported. Dividends and interest continue to be unreported in substantial amounts. The present exclusion of old-age and survivors insurance and railroad retirement benefits should be re-examined. Under present practice, interest on state and local bonds and other obligations is excluded from gross income. Another line of attack involves the capital gains provisions. Re-examination and general tightening of all provisions under which income from various sources is accorded capital gains treatment would result in some broadening of the tax base and an even larger proportionate expansion of revenues.

The optional standard deduction should be discontinued. Taxpayers are now entitled to a deduction of 10 per cent of adjusted gross income or \$1,000—whichever is lower. This deduction can be claimed even though the taxpayer would not have any allowable deductions if only itemized deductions were allowed. Since the tax advantage is available, regardless of whether any contributions are made, the optional deduction works to the disadvantage of charitable, educational, and scientific organizations that derive all or part of their income from contributions. For this reason, it is opposed by the National Council of Churches, among other organizations. This deduction is in effect "a premium for not giving." From an equity standpoint the optional standard deduction seems indefensible. A

¹⁵ It is important to keep in mind that growth is one among a number of objectives. See Norman B. Ture, "Economic Growth and Federal Tax Policy," in *Proceedings of the Fifty-first Annual Conference on Taxation*, 1958 (Harrisburg, Pa.: National Tax Association, 1959), pp. 388 ff.

¹⁶ *The Federal Revenue System: Facts and Problems 1959*, Materials Assembled by the Committee Staff for the Joint Economic Committee, 86th Congress, 1st Session (Washington, D. C.: US Printing Office, 1959), p. 9.

middle-income married couple with other allowable deductions of \$100 that gives \$900 per annum for charitable, educational, and religious purposes obtains no tax advantage whatever, as compared with a couple similarly situated that does not contribute to such institutions. For the latter couple the optional standard deduction is equivalent to an additional exemption of \$900. The desirability of deductions on account of contributions for charitable, educational, and religious purposes is universally accepted. The only question relates to the level of permissible allowances. Since World War II, allowable deductions were increased from 15 to 20 per cent of adjusted gross income and later to 30 per cent provided the additional 10 per cent goes to specified purposes. These contributions are used for purposes strongly affected with a public interest. On the other hand, one may well ask: Is there any higher public purpose than the adequate defense of the United States? This question, it is believed, should be carefully weighed in any re-examination of these deductions.¹⁷

The base for the corporate income tax is substantially smaller than the optimum. It has been estimated that for 1955 over 8 billion dollars of corporate income was excluded from the base for this tax. A first policy goal should be to prevent further erosion. A second and equally important goal should be the subjection of all provisions that authorize or permit exclusion or special treatment of income to the closest scrutiny, with a view to broadening the base. In particular, the depletion allowances and all cases of special treat-

ment for specific industries should be re-examined.¹⁸

For American taxpayers generally, broadening the federal income tax bases is of vital importance. Equity considerations alone suggest the desirability of this course. It is obvious that the broader the tax base, the lower the rate schedule required to yield a given volume of revenue. The possibilities in this regard were fully explored in the careful analyses of Pechman and Hellmuth. Pechman concluded that a personal income tax rate schedule with rates ranging from 15 to 68 per cent, instead of the present 20 to 91 per cent, might be possible. Similarly, Hellmuth's study indicated that corporate income tax rates of 21 per cent on the first \$25,000 and 43 per cent on all above \$25,000 might be feasible; present rates are 30 per cent and 52 per cent.

Public policies with respect to tax bases, allowances, and exemptions are deeply rooted in conceptions of the role of government that are now largely outmoded. Throughout the nineteenth century and the first third of the present century, government was viewed primarily as a burden on the private sector of the economy. Underlying most discussions of taxes and governmental activities was the assumption that public expenditures are less desirable than private spending. The complementarity of private and public activities stressed by Henry Carter Adams, among others, had not yet gained wide acceptance. Allowances for contributions to charitable institutions and the like were justified

¹⁷ For a discussion of the erosion of the personal income tax base, see Joseph A. Pechman, "The Individual Income Tax Base," *Proceedings of the Forty-eighth Annual Conference on Taxation, 1955* (Sacramento, Calif.: National Tax Association, 1956), pp. 304 ff.

¹⁸ Because of space limitations, the possibilities of broadening the corporate tax base cannot here be considered in detail. See William F. Hellmuth, Jr., "Erosion of the Federal Corporation Income Tax Base," *ibid.*, pp. 315 ff. Depletion allowances and special treatment for specific industries affect the personal income tax base as well as the corporate tax base.

or rationalized on the ground they were for a higher public use.

Acceptance of the modern view that private and governmental activities are complementary does not invalidate the doctrine of higher public use. Rather, it merely requires that the order of priorities be re-examined. At the present juncture one may well ask: Is there any

higher public use than the allocation to government of the financial and material resources required for the defense of the United States? Are any expenditures more important than those for public-school and higher education, including training in the advanced technology associated with the atomic space age?

Managing the Public Debt

By B. U. RATCHFORD

ABSTRACT: Debt management includes decisions about the composition and terms, but not about the amount, of the public debt. The heart of the countercyclical debt management theory is that short-term obligations provide liquidity and induce spending while long-term obligations do the reverse. The effects of such management are indirect, uncertain, and weak and may be redundant if monetary policy is adequate. Debt management is less flexible than monetary policy, and its effects may persist after a change of policy is required and thus become an obstacle to the effectiveness of monetary policy. In a recession, short-term financing tends to raise short-term interest rates and may delay a resumption of spending by offering attractive returns on funds. In recent years the average maturity of the debt has been declining, thus increasing the possibilities of inflation. The only two recent occasions on which the debt was lengthened moderately were in periods of recession; apparently the lengthening did not delay recovery. The potentialities of countercyclical debt management have been overemphasized in recent years, especially if an effective monetary policy is assumed. At least one competent student of the problem advocates substituting cost for economic stabilization as the proper criterion for debt management.

B. U. Ratchford, Ph.D., Litt.D., Durham, N. C., is Professor of Economics at Duke University and has been on the staff of that institution since 1928. He has been Director of Research for the NPA Committee on the South and President of the Southern Economic Association and is now Chairman of the Inter-University Committee for Economic Research on the South. He has served with OPA, ECA, U. S. Military Government, and the IBRD Mission to Turkey. Dr. Ratchford has written various articles for professional journals and is the author or co-author of American State Debts (1941), Berlin Reparations Assignment (1947), Economic Resources and Policies of the South (1951), The Economy of Turkey (1951), and Public Expenditures in Australia (1959).

IN recent years it has generally been accepted that countercyclical management of the federal debt is an important measure for the control of inflation and deflation. It does have significance as a stabilization device, but its importance has often been overestimated because of misconceptions about its nature, scope, and inherent capabilities.

Perhaps the most popular misconception about debt management is that it includes decisions about the amount of the debt. With one exception this is incorrect. Within limits—which may be very narrow when the debt ceiling is tight—Department of the Treasury officials can determine how large a cash balance to carry and where it will be deposited; these decisions may have significant effects of a monetary nature. But with this one exception, the size of the debt is determined by the results of fiscal policy—that is, decisions about revenues and expenditures.

Stein defines debt management as policy regarding the composition of the federal debt held outside the government and the Federal Reserve Banks. He notes that the size of the debt held outside the government is a matter of budget policy while the amount held by the Federal Reserve Banks is an aspect of monetary policy.¹ In much the same way, Murphy has pointed out that debt management is "bounded on one side by the factors determining the receipts and expenditures . . ." and "on the other side by monetary policy."²

¹ Herbert Stein, "Managing the Federal Debt," *The Journal of Law and Economics*, Vol. 1 (Oct. 1958), pp. 97-98.

² Henry C. Murphy, "Debt Management," in Kenyon E. Poole (Ed.), *Fiscal Policies and the American Economy* (New York: Prentice-Hall, 1951), p. 158. Murphy defines debt management in greater detail as the power "to fix the terms of new issues of public debt securities—that is, their maturities, rates of interest, redeemability or optional call provisions, tax exemption privileges, if any, and

Defined in this way, debt management loses much of its importance and tends to be overshadowed by fiscal and monetary policy. It is restricted even further when the managers of the debt must "meet the test of the market" with respect to interest rates, maturities, and other detailed provisions of the contract and when, as at present (July 1959), they are hamstrung by the rigid ceiling on the interest rate which may be offered on long-term bonds.

THE THEORY OF DEBT MANAGEMENT

The effects of debt management upon incomes, the general price level, and economic activity are exerted only indirectly. Fiscal policy, by varying revenues and expenditures, can affect incomes directly. Monetary policy acts more indirectly; it can vary the supply of money, but changes in the velocity of money may offset or reduce the effects of changes in amount. Debt management exerts its effects still more indirectly since it operates upon the factors which influence the supply of money and of near money or money substitutes.

The theory that debt management can be used as a means of economic stabilization rests basically upon the proposition that the composition of the debt affects the liquidity of the economy. The reasoning is that short-term obligations are more liquid, more nearly like money, and better substitutes for money than are long-term obligations. The short-term obligations are safer and more appropriate investments for commercial banks if and when they wish to invest surplus funds. Nonbanking business firms and individuals can use them as a money substitute, reduce their holdings of real money, and thus increase the velocity of the money supply. This means that if the need is for greater

all other provisions of the contract between borrower and lender." *Ibid.*, p. 159.

liquidity and more spending, debt management should work toward a larger proportion of short-term obligations in the total debt while if the need is to restrain demand, lower liquidity, and reduce spending, it should work toward a higher proportion of long-term obligations.

But the control of liquidity is primarily the responsibility of monetary policy. If monetary policy is able to perform that function satisfactorily, the efforts of debt management to control liquidity may be superfluous and redundant. Or, since monetary and debt management policies are determined by separate agencies, the two policies may at times work at cross purposes. Thus the significant question would seem to be whether the monetary authorities can do the job alone, or, as Stein puts it, whether debt management can do anything that monetary policy cannot do. If not, Stein holds that here are two reasons why debt management should not be used for this particular purpose: (1) the division of responsibility between different agencies permits evasion of responsibility, and (2) countercyclical debt policy may have a cost in terms of other objectives, especially in interest cost.³

In certain respects it is possible to argue that, subject to a qualification noted below, monetary policy can do the job better without collaboration of debt management. Monetary policy can be reversed quickly and completely; changes in debt management policies require more time, are less complete, and at times may be quite difficult and even almost impossible. In fact, the postwar experience indicates that in practice debt management has been to a considerable extent a one-way street—toward shorter maturities and greater liquidity. As Robinson points out:

³ Stein, *op. cit.* (note 1 *supra*), p. 99.

There is never any difficulty in making the public debt more liquid. . . . But the debt cannot be made less liquid quickly; this is a slow process. Barring authoritarian methods of refunding, the public debt can be made less liquid only by the slow process of selling investors on the advantages of buying new securities that are less liquid than those they are holding. And to get them to do this voluntarily would require offering various inducements, possibly of a fairly costly sort.⁴

Following a recession in which both monetary and debt policies have been directed toward greater liquidity and lower interest rates, it may be necessary to act quickly to forestall an incipient inflation. The central bank adopts measures to "mop up" excess funds and tighten credit, but large amounts of near money in the form of short-term obligations are afloat in the economy to blunt the effectiveness of monetary measures. These liquid assets increase what Smith calls "the resiliency of the financial system." The widely held public debt, he says, "has constituted a means of mobilizing the existing supply of funds more effectively in support of economic activity at times when the supply of new bank credit was being restricted by Federal Reserve policies."⁵ Thus the overhang or delayed effects of debt policy may constitute an obstruction or a handicap to the effectiveness of monetary policy.

In another way countercyclical debt policy may defeat or weaken the effects of monetary policy. In a recession the object of monetary policy is to provide more liquidity in the economy. There can be little doubt that the central

⁴Roland I. Robinson, "Monetary Aspects of Fiscal Policy," in Poole (Ed.), *op. cit.* (note 2 *supra*), pp. 91-92.

⁵ Warren L. Smith, "Some Unsettled Issues in Monetary Policy," in The Second Duke American Assembly, *United States Monetary Policy* (Durham, N. C.: Second Duke American Assembly, 1959), p. 20.

bank, if it is sufficiently determined, can create any amount of liquidity deemed desirable. But, of course, liquidity is not an end in itself; it is only a means to an end. The desired goal is to induce the holders of funds to resume spending. If at such a time the government is selling large amounts of short-term obligations, this will tend to raise short-term interest rates. Holders of funds then have the possibility of holding assets nearly the equivalent of money and at the same time realizing an attractive return on them. This may delay rather than speed the resumption of spending. The ultimate goal of monetary policy might be realized more speedily if the holders of funds had only the alternative of spending their funds, for investment or consumption, or of holding real money which yields no return. Again it must be emphasized that the central bank can, within reason, create any amount of bank reserves it wishes and thus drive down short-term interest rates to very low levels. However, in so doing it might have to flood the market with funds which could be troublesome when it became necessary to reverse policy.

Earlier it was noted that there was one qualification to the above argument. That qualification is that when it becomes desirable to induce an increase in the money supply, there must be available in the economy an adequate supply of liquid assets suitable for commercial banks to purchase and hold. Short- and medium-term obligations of the federal government are among the most desirable types of such assets.

It is the responsibility of debt management to see that there is available a proper amount of appropriate federal obligations to meet the needs of commercial banks. This, however, is no problem at present. In addition to the large amount of short- and medium-

term federal obligations there is an ever-increasing amount of the obligations of state and local governments which commercial banks buy and hold in substantial amounts. In any event, this particular aspect of the problem is more a matter of countering deflation than it is of resisting inflation.

OTHER ASPECTS OF DEBT MANAGEMENT

In recent years the Treasury has waged a constant, and largely unsuccessful, struggle against a steady shortening of the debt. The passage of time will bring about such a shortening unless medium- or long-term obligations are issued from time to time. In addition to the fact that it may cause too much liquidity, an excessive short-term debt carries two other dangers. First, the short maturities may be monetized by being purchased by commercial banks. "In lieu of an increase in near money we then face an increase in money itself."⁶ Second, a large short-term debt requires the Treasury to go to the market frequently for refinancing. During such periods of financing, "the Federal Reserve cannot use its credit controls as freely as at other times" and this "may permit a kind of inflationary leakage to occur."⁷

Despite these dangers, there are several factors constantly pushing the Treasury toward excessive short-term financing. First, short-term rates are usually lower than long-term rates and thus long-term financing raises the interest cost. Second, short-term financing is more certain and reliable. Treasury Bills, the shortest obligations, can

⁶ Henry C. Wallich, "Public Debt Management and Economic Stabilization Policy," in *The Second Duke American Assembly*, *op. cit.* (note 5 *supra*), p. 37.

⁷ *Ibid.*, p. 37.

be offered on an auction basis, allowing the market to set its own rate; this avoids the danger of a failure because the Treasury has set a rate which is too low. Further, in refunding, the Treasury frequently offers holders of maturing securities a choice of several different maturities. "Typically the shortest issue offered becomes the 'anchor' of the operation which must assure its success if the longer issue or issues prove less attractive than anticipated."⁸ Third, the Administration may decide against the use of long-term issues for political reasons. In 1956 and 1957, when countercyclical policy indicated the use of long-term obligations, both President Eisenhower and Secretary Humphrey stated that there would be no long-term issues because the federal government should not compete with housing, private firms, and state and local governments for long-term capital funds. Fourth, with respect to large institutional investors, the Treasury is competing with itself for long-term funds by offering guaranteed and insured mortgages which yield more than direct Treasury obligations. Finally, the market may be strongly averse to long-term issues and the Treasury may be unable to offer interest rates sufficient to sell such obligations. Since about the middle of 1958 the fear of inflation has driven many investors away from fixed dollar obligations and into equities. In the face of rising interest rates, the Treasury is caught by a ceiling on the rate of interest it can pay on bonds. It cannot offer a rate of interest which would enable it to sell bonds at par, and it has a strong aversion to selling bonds at a discount. As a result it can offer only short- and medium-term obligations.

In view of the potential dangers of an excessive short-term debt and of the

many factors pushing the Treasury in that direction, perhaps the greatest contribution debt management could make to the fight against inflation would be to find some way to reduce the reliance of the Treasury on short-term financing. Actually, however, circumstances of recent years have forced a greater rather than a smaller reliance upon the shorter maturities. Within the past three years there has been a fundamental shift in the sources of funds available for the purchase of government obligations. This shift was especially evident in 1957 and 1958, but it is likely that important elements of it will be permanent. Table 1 gives a statistical summary of this shift; its implications for the future of debt management are of major importance.⁹

Briefly Table 1 shows that from 1947 through 1956 three sources provided nearly all of the funds for the purchase of government securities. In the order of their importance they were: United States government investment accounts; state and local governments; and miscellaneous investors, a considerable number of whom were foreigners. Together their net purchases amounted to about 4 billion dollars per year. But by 1958 conditions had changed radically; government investment accounts were liquidating investments to meet the heavy claims on them; state and local governments were turning to more attractive investments; and foreigners did not hold the dollar in such high regard in relation to their own currencies as formerly. The result was that these three groups made net sales of securities of 0.5 billion dollars in 1958. At the same time individuals, who had

⁹ The data in this table cover all maturities and all holders of government securities, governmental as well as nongovernmental. This approach is dictated by the form in which the data are made available.

⁸ *Ibid.*, p. 35.

TABLE 1—CHANGES IN THE OWNERSHIP OF UNITED STATES GOVERNMENT SECURITIES
(Amounts in \$ billions)

CLASS OF HOLDER	AVERAGE ANNUAL CHANGE, 1947-56	CHANGE IN 1957	CHANGE IN 1958
United States Government Investment			
Accounts.....	+2.3	+1.2	-0.8
Federal Reserve Banks.....	+0.2	-0.7	+2.2
Commercial Banks.....	-1.5	-0.2	+8.1
Mutual Savings Banks and Insurance Companies.....	-1.6	-1.3	-0.2
Other (Nonfinancial) Corporations.....	+0.3	-1.7	+0.4
State and Local Governments.....	+1.0	+0.9	+0.3
Individuals.....	+0.3	-0.5	-1.7
Miscellaneous Investors.....	+0.8	+0.4	...
Total Debt.....	+1.7	-1.7	+8.0

Source: *Treasury Bulletin* (April 1958), p. 44.

been small net buyers, made net sales of 1.7 billion dollars of securities.

Between 1947 and 1956 commercial banks, mutual savings banks, and insurance companies, on the average, liquidated about 3 billion dollars of federal securities per year. In 1958 the demand for loans fell off and the Federal Reserve System lowered reserve requirements. Commercial banks made net purchases of 8.1 billion dollars of securities—almost exactly the amount by which the debt increased. By a fortuitous development, the Federal Reserve Banks were able to buy 2.2 billion dollars of securities without increasing bank reserves. Gold flowed out by about that same amount, and the Reserve Banks merely purchased securities to replace the reserves lost by the gold outflow.

Commercial banks are now selling securities again as the business boom progresses and credit is kept tight. The liquidation by government investment accounts has halted, but it will be a considerable time before they again buy as heavily as they did between 1947 and 1956. The Treasury must indeed look hard to find purchasers for any new securities it must sell and to replace old

security holders who want to liquidate.

THE PRACTICE VS. THE THEORY OF DEBT MANAGEMENT

With only a few small interruptions, the average maturity of the marketable debt of the United States has steadily declined since World War II. Between 1946 and 1951 the Treasury, in addition to rolling over bill issues weekly, engaged in fifty-six debt operations. None of the issues offered to the public ran for as long as five years and only three ran for as long as two years.¹⁰ In the meantime the average maturity fell from about eleven years at the end of the war to six years, seven months on June 30, 1951.

The Eisenhower Administration came to power pledged to lengthen the debt and made several efforts to do so. It scored a few temporary successes but on the whole lost ground. The average maturity fell from five years, four months in 1953 to four years, nine months at the end of February 1959.

¹⁰ See my article, "Some Aspects of Debt Management in the United States," *Public Finance* (No. 2/1955), p. 135.

It is impossible to measure what contribution, if any, the shortening of the debt made toward the inflation which has prevailed generally since World War II because innumerable other factors were at work. It would certainly be illogical, however, to contend that the shortening helped to restrain inflation. It would seem quite likely that it has made it more difficult for the Federal Reserve System to make its credit policies effective.

It is noteworthy that the two periods in which the debt was lengthened moderately were in periods of recession. In 1954 and the early part of 1955, the average maturity was increased from five years to six years, one month. Since it is generally admitted, in the light of hindsight, that the Federal Reserve System created too many bank reserves at that time and thus set the stage for the inflation of 1956-57, it would seem that the lengthening did no harm and perhaps made a contribution toward stabilization. The other period of lengthening was in the early part of 1958, when the Treasury sold 4.2 billion dollars of long-term and 12.7 billion dollars of medium-term bonds. The average maturity was increased from four years, seven months to five years, two months. In view of the short length of the downswing, the rapid recovery we have had since then, and the necessity for applying credit restraints since the middle of 1958, it would seem that this experience, too, was at least harmless and perhaps helpful.

Perhaps it was considerations of this kind, among others, which led Stein to break away from the theory of debt management which has been generally accepted in recent years. He says:

The proper guide to cyclical management of the debt should not be economic stabilization. More long term debt should be issued in recessions, more short term debt in booms. This would hold down the Fed-

eral interest burden, reduce fluctuations in long-term interest rates and leave to monetary policy the responsibility for helping to stabilize total monetary expenditures through influencing the supply of money, supply of liquid assets, asset values and interest rates.¹¹

As to whether it would be desirable to lengthen the debt beyond its present level, he says that this is almost entirely a matter of cost because "considerations other than cost seem so uncertain, on balance, as not to justify lengthening the debt if substantially more interest cost would be required."¹²

CONCLUSION

In summary, the central core of the theory of countercyclical management of the debt is that the composition of the debt affects the liquidity of the economy—shorter maturities give more liquidity and encourage spending and vice versa. This effect is necessarily indirect, uncertain, and weak, and it may be redundant if monetary policy has already caused the desired change in liquidity. Changes in debt policy require more time than changes in monetary policy, and the effects of a given debt policy may lap over into a following period and constitute an obstacle to effective monetary policy. Short-term financing of the debt in a recession tends to raise short-term interest rates and may delay the resumption of spending by providing an attractive return on funds.

It seems clear that the potentialities of countercyclical debt management have been overemphasized in much of the stabilization literature of recent years. This is true especially if a reasonable effectiveness is assumed for monetary policy. Furthermore, reflecting the ideological lag from the prewar

¹¹ Stein, *op. cit.* (note 1 *supra*), p. 101.

¹² *Ibid.*, p. 103.

depression era, the emphasis has been disproportionately heavy on the inflationary or stimulating possibilities of debt management. On the other hand, relatively little attention has been given to its anti-inflationary or restraining effects, either in theory or in practice.

This has come about because it is sometimes assumed, often unconsciously, that any device or practice which can make even a small contribution toward stabilization should be used to the hilt

for that purpose regardless of problems it might create in other fields. Further, those who do this usually do not have a very high opinion of the potentialities of monetary policy. The difficulties of the Treasury in the past year have shown us that unwise or shortsighted financial planning of the debt can offset, or more than offset, any constructive contribution which debt management can make toward economic stabilization.

Financing Business and Consumer Needs Without Inflation

By HOWARD S. ELLIS

ABSTRACT: "Needs" for short-run inventory credit formed the basis of a particular school of thought regarding monetary policy early in the nineteenth century in England, and this philosophy imbued the Federal Reserve in the United States at its inception. In the early 1930's, a swing of the pendulum in the opposite direction brought into dominance the Quantity Theory, which denied any relevance of business and consumer needs to desirable credit policy. The state was supreme in these matters and could, through appropriate central bank operation, control the quantity and availability of bank credit and hence—it was thought—the evolution of prices and production. Nowadays the position is less simple. Nonbank financial organizations and firms can create near moneys, and the needs of producers for credit may be satisfied outside the banking system. This may reduce the efficacy of Federal Reserve control of inflation; but the control exercised by the Federal Reserve over money may be sufficient to master the situation in all money and credit markets. On the other hand, effective control of inflation does in fact seem to be jeopardized by monopoly pricing by industries and by labor unions; a "need" for money is thus created which is not easily denied by the monetary authority. Some types of direct control of monopoly practices may become unavoidable.

*Howard S. Ellis, Ph.D., LL.D., Berkeley, California, is Flood Professor of Economics, University of California. He was Assistant Director of Research and Statistics for the Board of Governors of the Federal Reserve System from 1943 to 1945 and Director of the Marshall Aid Research Project, Council on Foreign Relations in 1949 and 1950. He has served as a visiting Professor to the University of Tokyo, the University of Bombay, and Columbia University. President of the International Economic Association from 1953 to 1956, he also served as President of the American Economic Association in 1949. Dr. Ellis is the author of *Approaches to Economic Development* (1955), *Exchange Control in Central Europe* (1941), and *German Monetary Theory 1905-1933* (1934) and the editor of *A Survey of Contemporary Economics*, Vol. 1 (1948).*

JUST what roles the needs of producers and consumers play in the creation of credit and what responsibilities, if any, attach to producers and consumers individually for the avoidance of inflation is probably best considered from the vantage point of a brief historical retrospect. Against the background of abandoned or modified dogmas, present attitudes take on their full meaning.

THE BANKING SCHOOL

In discussions pertaining to the establishment of a sound banking and currency system following the disturbances produced in England by the Napoleonic wars, a certain set of doctrines evolved by the so-called "Banking School" of economists and journalists was destined to become classical. For nearly a century these ideas held virtually unshaken dominance, and in some quarters and in some guises they still persist. According to this school, a sound currency and banking system requires unswerving adherence to one great rule: bank credit, whether in the form of banknotes or demand deposits, should be created only upon evidence of debt arising from goods in the process of manufacture or sale. Bank lending to consumers was simply taboo. The need of business for inventory credit was thus the supreme mandate for monetary and credit policy; the need of consumers was ruled out of court.

According to the Banking School doctrine, if credit was called into being as a particular "batch" of goods came into being and extinguished when these goods came in the hands of the final purchaser, a perfect parallel of goods and money was guaranteed. Money could never be excessive in quantity and cause inflation; loans were perfectly liquid; speculative misuses of credit were precluded. So far as concerns the responsibility for maintaining sound

monetary and financial conditions, it is evident that, according to the Banking School philosophy, neither government, producer, nor consumer was answerable. Responsibility rested squarely upon the individual banker for preserving the purity of a credit system based exclusively upon "prime commercial paper" or "real bills," as the instruments emanating from inventory loans were called. The central bank was not invested with discretionary authority. Its function consisted in meeting the "needs of trade" by supporting the commercial banks when necessary by taking over part of their holdings of "real bills." It may be surprising to many Americans to learn that these Banking School doctrines imbued the Federal Reserve System at its inception and that they apparently still find credence in the USSR.¹

In the presently accepted lore of bank examinations, something of this ancient dogma still persists in the high regard accorded by the regulating authorities to producer—and particularly inventory—loans, even though strict commercial credit today consists of only a fraction of bank lending. Otherwise Banking School ideas have been completely superseded. The neat "parallel" of goods and money resting upon prime commercial paper was discovered to be an empty truism. A rise of prices could make any amount of money equal to the existing flow of goods—inflation was the very way the "parallel" asserted itself. As for the guarantee that the great rule of classical banking was supposed to afford against the speculative use of credit, it came to be realized that the most solid merchant or manufacturer could, if he wished, circumvent the rule by borrowing on inventory and

¹ Cf. the doctoral dissertation by Raymond P. Powell on "The Money and Banking System of the U.S.S.R.," on deposit at the University of California, Berkeley.

using his own funds for speculation. Or banknotes or deposits, originally called into being on credits to carry goods in process of manufacture, could circulate into other hands and thus perhaps into the nefarious business of speculation. Finally the harsh lesson had to be learned that in time of crisis or depression the vaunted self-liquidation of inventory loans disappeared. In the universal rush for liquidity, the exchanging of goods for money could drive prices far below the level at which the loans had been extended.

THE QUANTITY THEORY

If these facts were not sufficiently revealed to careful students by the inflations, crises, and depressions of earlier history, they became amply evident in the Great Depression of the 1930's. The Banking Acts of 1933 and 1935 marked the legal recognition of a de facto abandonment of Banking School beliefs and practices which had gradually been adhered to almost from the inception of the Federal Reserve System. Into the gap left by this abandonment came the Quantity Theory with a completely different concept of the role of the needs of businessmen and private persons in the monetary system. According to the implications of this theory, needs for credit are simply limitless at sufficiently high commodity prices or at sufficiently low rates of interest. Consequently these needs supply no criterion for monetary policy. Indeed no rule as to the type of lending by banks can suffice to control inflation. The behavior of prices depends simply upon the quantities of money and credit in existence and upon their velocities of circulation, without regard to the occasion for the coming into being of these quantities.

To control inflation, therefore, the absolutely necessary, as well as the vir-

tuously sufficient, condition according to Quantity Theory postulates, was to control the quantity of money, usually envisaged as the amount of currency in circulation plus demand deposits. This concept of money as something contrasting categorically in its perfect liquidity with everything else was included as one piece of complete orthodoxy in the otherwise rather heterodox system of economics by J. M. Keynes.

On the basis of the Quantity Theory, it is natural that the only real responsibility for stable prices and employment should attach to the state. "Das Geld ist ein Geschöpf der Rechtsordnung," Georg Friederich Knapp had once written: "Money is a creation of the law." The role of the central bank was no longer to be described in terms of satisfying the needs of trade; businessmen and consumers could not be held individually responsible for inflation, deflation, overly full employment, unemployment, and so forth. These were matters for the monetary authority, in conjunction with appropriate fiscal action, to control or eliminate. This straightforward, if somewhat too simple, monetary theory enjoyed wide currency in the 1920's and 1930's, although significant modifications began to appear in the latter part of the Great Depression and again in the war and postwar periods.

NEAR MONEYS; NONMONETARY FORCES

Among many other criticisms, Keynes' General Theory² provoked the observation that, while money is undoubtedly perfectly liquid as he maintained, other claims or evidences of debt—such as savings deposits, stocks and bonds, consumer credit, mortgage, and so forth—represent varying degrees of liquidity.

² J. M. Keynes, *The General Theory of Employment, Interest, and Money* (New York: Harcourt, Brace and Company, 1936).

They are, also in varying degrees, near moneys or money substitutes. This observation was powerfully reinforced during the war by the appearance of the Series E bonds, which were almost perfectly liquid assets for ordinary citizens and by the large mass of Treasury bills and other short-dated government securities, which banks and firms could regard as virtual money. Thus the need of consumers and producers for liquid balances could be supplied almost perfectly by these short maturities, and in lesser degree, by longer dated maturities, private as well as government. Near moneys such as these, it was recognized, had to be exchanged for money before being used as means of payment, and in this respect the Quantity Theory stood intact. But in the function of a "store of value" other claims running in monetary terms could, in greater or lesser degree, compete with balances in cash or deposits held by persons, firms, or the government. So much for a newer interpretation of the "need" for money and credit when viewed from the angle of those who need or demand liquid balances to hold against recurring payments or against contingencies.

Further modification of strict Quantity Theory premises and deductions, for pure theory and for practice as well, was due to come from the side of supply of money, in the sense of money loans in various forms. The researches of Raymond Goldsmith and of Shaw and Gurley revealed a large increase over the last few decades of nonbank institutional lenders such as finance companies, building and loan associations, insurance companies, and so forth.³ The "need" of producers and consumers here takes on the sense of

their desire to purchase securities of particular sorts adapted to individual tastes and requirements.

The ability of nonbank lenders to supply funds independently of the banks suggested to some writers that central bank controls, limited as they are to the quantity of money and bank credit, are incapable of controlling credit in the aggregate. Payments, it was conceded, would finally have to be effected in money or in demand deposits; but the nonbank "financial intermediaries" could vitiate Federal Reserve controls through a more intensive utilization of existing volumes of currency and demand deposits. This powerful leverage would be exercised by the market via the velocity of circulation of money and deposits, if one chose to stay by the language of the Quantity Theory. But no answer of deference to traditional terms could alter the fact, according to this way of thinking, that responsibility for economic stability, so far as it depended upon money and credit, had passed from the control of bank credit to "financial control" in an inclusive sense.

In retrospect, the emphasis upon the role of money substitutes or near moneys has served to restore, at least to some degree, the importance of businessmen's and consumers' need in monetary theory and policy. First, near moneys can, to an extent determined by the individual or firm, take the place of money in the provision of liquidity, thus increasing the potency of a given sense of need, the desire of investors and lenders for an extensive array of specialized securities. Second, there is a factor operating to increase purchasing power through the increased velocity of currency and deposits.

Before we can come to an evaluation of the practical significance of these innovations, we ought probably to take account of another possible interpreta-

³ Cf. J. G. Gurley and E. S. Shaw, "The Growth of Debt and Money in the United States, 1800-1950," *The Review of Economics and Statistics*, Vol. 39, No. 3 (August 1957), pp. 250-62.

tion of "need." If the prices of commodities and/or services are determined in some other way than through the forces of competition on free and open markets, the possibility is certainly given that money and credit appear as residuals or results rather than as active causes of the behavior of prices and employment. In Marxian economics, where labor cost determines values and prices, money is a mere appendage, adjusting itself by the hoarding or dis-hoarding of the public to a predetermined "socially necessary circulation value."

In contemporary discussions, somewhat analogous positions are represented by the "cost-push" theories. Prices are either directly determined by industrial monopolies, "administered prices," or they are the indirect consequence of an equally arbitrary settlement of wages through collective bargaining. In these settings, the amount of money and credit is adjusted by the individual holders of money balances, by the banks, and, presumably also, by the monetary authority to what is "necessary" at predetermined prices. In this context, "necessary" may—according to the various political or social creeds prevailing in a given country—mean a certain degree of economic stability, or "full employment," or such an amount of employment or output as to satisfy one or another of several conceivable objectives, such as a Five Year Plan, a balance of payments goal, and so forth.

DOES NEED RULE THE ROOST?

From the historical retrospect, several deductions can be made with reasonable certainty. In the first place, contrary to the Banking School, the needs of industry and trade for inventory credit supply no reliable criterion for sound banking or for a stable monetary

system. Responsibility of the state cannot be avoided by any such automatic rule.⁴ At the other extreme, the existence of near moneys and the autonomus determination of prices by labor and commodity monopolies make it likewise impossible to invest the Central Bank with such responsibility for the behavior of money and credit. Currently the difficult task of the economist is to estimate the degree to which the needs of trade in one or another significant sense are able to assert themselves independently of, or perhaps in direct opposition to, Federal Reserve policies.

Consider first the growth of near moneys emanating in an increased velocity of actual money. According to an analysis of Professor John G. Gurley, the gross national product of the United States rose by 50 billion dollars from 1955 to 1957, the rise of prices meanwhile accounting for half this increase. In the same interval, the money supply was augmented by 3.3 billion dollars and velocity rose by 15. Thus, concludes Professor Gurley, the increment to velocity was four times as powerful as the increment to money.⁵

Most economists would be loath to quantify the importance of velocity compared to the stock of money as precisely as Gurley, and many economists would directly reverse the order of importance. Professor Arthur F. Burns notes the increase of money substitutes in recent years but believes that inflation cannot get out of hand if the quantity of money is controlled.⁶ In similar vein, Professor Haberler believes that

⁴ Or by any other automatic rule; but this is too wide a subject for the present paper.

⁵ J. G. Gurley, "Agenda for a National Monetary Commission: Discussion," *American Economic Review*, Vol. 48, No. 2, Papers and Proceedings (May 1958), p. 104.

⁶ Arthur F. Burns, *Prosperity Without Inflation* (Garden City, New York: Doubleday and Company, 1958), p. 15.

a rise in velocity by itself has never caused or substantially intensified serious inflationary trouble.⁷

One thing is certain, that mere changes in velocity are not in themselves direct evidence of the increased importance of near moneys or of the insufficiency of monetary, as contrasted with much more inclusive, "financial" controls. Over the decade 1947-57 velocity of circulation in the United Kingdom rose from 20 to 47 per annum, in the United States from 13 to 22.⁸ It is quite possible and indeed probable that part, and conceivably all, of this change could have arisen from a gradual adjustment of balance holders to the liquidity ratios which prevailed before the enforced hoarding of war and post-war years through commodity rationing. But even if part of this change in velocity is accountable through the growth of money substitutes, it might still be possible that such a phenomenon was primarily a matter of secular change, and that the significance of near moneys for short run variations is not great. Some economists, indeed, have argued that the existence of a large volume of credit beside commercial bank loans renders the whole financial structure more rather than less sensitive to changes in the discount rate, open market operations, and reserve requirements of the Federal Reserve. At present the evidence is not clear either way; but it would be premature to minify the efficacy of traditional monetary controls for the short run stabilization of prices and employment, merely on the grounds that nonbank finance has grown relatively to bank credit.

⁷ Gottfried Haberler, "Internal Factors Causing and Propagating Inflation," International Economic Association, Roundtable on Inflation, Elsinore, Denmark, September 1959; mimeographed.

⁸ Bank for International Settlements, Twenty-eighth Annual Report (Basel, 1959), pp. 62, 98-99.

MONOPOLY PRICING BY BUSINESS AND LABOR

A more potent threat to the effective operation of monetary controls, particularly against inflation, is posed by monopoly pricing. Since labor is nowadays more aggressive than most industrial monopolies, the chief threat probably comes from collective bargaining. However it is not precluded that oligopoly and monopoly on the side of the sellers of goods also contribute to inflation. Professors John K. Galbraith and Gardner Means have recently emphasized the actual or potential role of administered commodity prices in inflation. By far the greater number of economists, however, have ascribed greater responsibility for recent periods of inflation to labor union wage demands. But the most aggressive unions are found exactly in those industries which are characterized by monopoly or oligopoly. Hence it is most difficult to separate the "cost-push" influences of labor unions on the one hand from commodity monopoly on the other. The dispute as to which is the more powerful inflationary force is apt to continue for some time.

Wage advances are inflationary, if the increases of money wages exceed increases in productivity expressed in terms of price, provided the increases in productivity are only those ascribable to improvements in labor efficiency and not to increased capital investment per laborer. Over the postwar period 1946-1957, a 90 per cent increase in hourly wage rates may be compared to a 37 per cent increase in output per man hour and a 44 per cent increase in the consumers' price index.⁹ With wage in-

⁹ Neil H. Jacoby, "Maintaining Prosperity Without Inflation: Objectives, Problems and Policies." Submitted to the Joint Economic Committee of Congress. Mimeographed, Los Angeles, March 28, 1958.

creases of this magnitude, it would seem virtually certain that they played an important role in the postwar inflation, particularly since a part of the 37 per cent increase in "output per man hour" is actually to be ascribed to increased capital investment per laborer and not to increased labor efficiency.

Labor or commodity monopolies tend to create a "need" for money or credit creation in order to avoid unemployment; they tend to deprive government of control of inflationary forces. A tight credit policy in this setting may have a restraining effect upon aggressive pricing tactics on the part of labor or

industry sufficient to avoid inflation. But individual businesses and individual unions derive a short-run advantage if they succeed in keeping their own price advances ahead of the general level. Thus a long-run failure to gain from inflation or even an actual loss is a weak restraining force over the field as a whole, and there is no guarantee that monetarary and fiscal controls may be able to master the drive of "cost push." It still remains to be seen whether a free enterprise economy such as that of the United States will be able to master the problem of inflation without some kind of direct controls on monopoly pricing.

Monetary Policy and Inflation

By C. CANBY BALDERSTON

ABSTRACT: Inflation does not stimulate sustainable growth; it just creates a temporary illusion of it. Real growth requires that competition do its work both at home and abroad. Competition must be allowed to produce the kind of flexible change that brings out the maximum use of resources and does not allow inefficiency to hide behind the shelter of monopoly or other forms of protection. Rapid growth requires use of the most advanced technology. That which is inefficient and outmoded must be abandoned quickly. To employ some form of protection merely to preserve the status quo, whether through subsidies, tariffs, or featherbedding, tends to retard growth. The problems of monetary policy are the problems of a society organized around the principles of free markets and freedom of choice. In an economy where freedom is exercised by individuals and by business units, effective regulation of the money system is of prime importance. In brief, the problems that are the concern of monetary policy in a free society are those which flow from the exercise of freedom in the use of money. Monetary policy cannot be successfully managed by formula because it must be adapted to the variety of our economy and to its changing moods.

C. Canby Balderston, Ph.D., Washington, D. C., is Vice Chairman of the Board of Governors of the Federal Reserve System. He served as Professor of Industry, Chairman of the Department of Geography and Industry, and Dean (1941-54) of the Wharton School of Finance and Commerce, University of Pennsylvania. At various times he has also served as President of Leeds and Lippincott Co., Trustee of Bryn Mawr College, President and later Chairman of the Board of the National Bureau of Economic Research, Director of the Wage Stabilization Unit, Headquarters, Army Service Forces (1942-45); Class C Director and Deputy Chairman, Federal Reserve Bank of Philadelphia, and Vice President of the Philadelphia Chamber of Commerce. Among other books, he is the author of Profit-Sharing for Wage Earners (1937) and Wage Setting (1940); he is a co-author of Vertical Integration in the Textile Industries (1938) and Management of a Textile Business (1938).

THE struggle to keep sound the monetary unit of a country is an issue centuries old. The great debate in which our country is engaged is neither new nor novel. Ancient and medieval history records the mismanagement of money that resulted from the perfidy of kings and the cupidity of speculators.

For example, debasement of the currency pervades early Roman history. By the third century BC the monetary unit, theoretically a pound of copper, actually weighed no more than 4 ounces; by about the year 89 BC, only $\frac{1}{2}$ ounce.¹ The coinage instituted by Augustus remained undisturbed for three-quarters of a century, but Nero, Trajan, and their successors debased both the gold aureus and the silver denarius. The fluctuations in the value of money affected Rome's foreign commerce seriously for, beyond the borders, traders required that they be paid in good silver. At home, gold was hoarded, and frightened men clutched at "bits of copper as the sole reality in a crumbling world."²

At long last the government sought to counteract the paralysis only to encounter the opposition of speculators. By the time of Diocletian, the disintegration had proceeded so far that the best that autocratic soldier could do was to re-establish uniform standards of weights and measures. Failing to achieve a currency standard, he resorted in AD 301 to his renowned price fixing to control the hysterical speculation. The decree covered items ranging from beer and silk to the services of shaving men and shearing sheep. But within five years the effort was abandoned as a failure, and an observer concluded "Money had more to do with the dis-

temper of the Roman Empire than the Huns or the Vandals."³

After the disruption caused by the dissolution of the Roman Empire, the use of money was slowly re-established. Barter was again replaced by the use of coin. The right of issuing money was a special prerogative of the sovereign power, which claimed the authority both to coin money and to debase it.

In England the Norman kings rarely tampered with the coinage, but Henry III began a process of debasing the currency, together with other forms of confiscation of wealth.⁴ The value of metallic currency suffered extreme changes in value just as credit currency has done subsequently. This practice continued while the Middle Ages gave way to the advent of Modern Times. Leading practitioners of the art of debasement were Henry IV,⁵ Edward IV,⁶ and Henry VIII.⁷

Gold entered the money system of Britain in the reign of Edward III, who thereupon encountered the problem of balancing the respective values of gold and silver. In the very year when his coin was debased for the last time, "it was enacted that the price of labour, under the new standard, should be restricted to its nominal amount under the old standard . . . whilst provisions were permitted to rise in value."⁸

Henry VIII had inherited immense wealth from his father, but his love of display led to such cupidity as to reduce the amount of silver in the coinage to one-fourth of its face value.⁹ Then, taxes were raised and both silver and

³ *Ibid.*, p. 44.

⁴ James Taylor, *A View of the Money System of England* (London: Littlewood & Co., 1828), p. 23.

⁵ *Ibid.*, p. 35.

⁶ *Ibid.*, p. 38.

⁷ *Ibid.*, p. 42.

⁸ *Ibid.*, pp. 32-33.

⁹ *Ibid.*, p. 42.

¹ Elgin Groseclose, *Money: The Human Conflict* (Norman: University of Oklahoma Press, 1934), p. 36.

² *Ibid.*, p. 41.

gold coin debased. Rents and food prices rose; even clipped silver, despised at other times, became scarce because no one would lend what he believed would be repaid in baser money. Henry's successor, Edward VI, devalued the currency so often that the unsuspecting people were robbed of half their money. The richer people "had knowledge of these changes beforehand . . . so that the chief loss fell on the lower orders."¹⁰

Finally came Elizabeth. She had both the ability and the will to bring the silver money of England to a par with its gold money. But even while her government was preparing to suppress the circulation of base monies in England, a commission was granted to the chief officers of the mint to coin base money for the Irish.¹¹ By this device the sophisticated English got rid of their base coin leaving the loss to fall upon the simple folk who were not "in the know."¹² "Elizabeth flattered herself that she had settled the money question upon a lasting basis; that 'she had [as she expressed it] conquered that monster which had so long devoured her people;' but the subsequent History of England, and even that of Elizabeth's own reign, shews that though his power was checked, the monster was not annihilated."¹³

INFLATION IN FRANCE

The French inflations have been well publicized and numerous. Between 768 and 1764 the livre of Charlemagne had declined to one sixty-sixth of its original value. To illustrate how the livre depreciated during the last part of that period, the price of a mark weight of gold in 1309 was 44 livres de compte;

four hundred years later, the purchase of a mark of gold required 576 livres. This was just before John Law secured control of the French currency.¹⁴

In fact, John Law's experiment with paper money was one of the best known of the French inflations. This Scot born financier had failed to convert his fellow Scotsmen to his theory of a land currency equal to the value of the land and to the value of actual coin outstanding. He had argued that the Scot people were poor because they had but little silver and gold. But he did win a convert in the Duke of Orleans, Regent of France. In France, Law promoted, not currency based upon land, but money secured by commercial credit. Starting with a private bank in 1716, he was so successful in bringing down interest rates that in 1718 he was looked upon as a financial wizard and his bank was converted into a state bank. Then began his ascent to power and prestige, culminating in a dramatic and tragic fall. To feed the great speculation known as the Mississippi bubble, he declared dividends that had not been earned. During 1719 the price of his shares rose 100 per cent in forty days. The ensuing security speculation was supported by printing press money. The rampant bull market drew speculators to Paris from all over Europe. The price of houses and farms tripled; that of bread doubled.¹⁵ Before the end of

1720, the state's paper currency was extinguished and Law fled the country. And so the Western world's first great experiment with paper money proved a fiasco because the supply was uncontrolled.

Still another contribution to our knowledge of inflation stemmed from the French Revolution. It has been so competently described in Andrew White's

¹⁰ *Ibid.*, p. 47.

¹¹ *Ibid.*, pp. 51-52.

¹² *Ibid.*, p. 52.

¹³ *Ibid.*, p. 60.

¹⁴ Groseclose, *op. cit.* (note 1 *supra*), p. 68.

¹⁵ *Ibid.*, p. 140.

*Fiat Money Inflation in France*¹⁶ that it can be passed over here in favor of France's most recent experience, halted in 1958 by firm measures continued by the government of General de Gaulle. At the end of 1955, France began to exhibit evidence of how overexpansion of economic activity tends to increase inflationary pressure. To the worldwide surge in demand was added the inflationary financing of a large government deficit of about 20 per cent of expenditures in both 1956 and 1957. Moreover, the bank credit extended to the private economy in each of these years proved excessive. There followed inflationary results according to the classic pattern. Between January 1956 and July 1957, France lost over half of her official reserves of gold and dollars. Almost immediately there was a de facto devaluation of the franc of 17 per cent. By the end of 1958, French prices were judged by the new de Gaulle regime as too high to compete in the markets of the world at the rate of exchange then in effect. Accordingly, the French franc was once more devalued—this time by 15 per cent. Miss Ruth Logue of the Board's staff observes that "quite aside from the fact that it would be difficult for any country to maintain such a high rate of expansion during a very long period, in France it was clearly unsustainable because it depended upon an import surplus paid for by the dissipation of foreign exchange reserves and by foreign aid."

The main domestic question of the moment in the United States is whether it can achieve the desired economic growth, with concomitant living standards and employment, and still preserve the purchasing power of the dollar. There are ancillary issues, however.

Can inflation actually be controlled in the face of upward wage pressures and of demands for increased governmental spending? Does general flexible monetary control, in combination with fiscal policy, have the power to keep inflation in check?

MONETARY POLICY AND OBJECTIVES

As long as monetary policy objectives are stated in general terms, there is little dispute. Everyone wants the country's standard of living to continue to rise. Strong economic activity and adequate job opportunities are goals that all agree upon, and so sustainable growth without inflation is high among accepted objectives. Political and economic freedoms are American hallmarks.

Monetary policy actions, however, must be specific, and decisions on such actions must be made in relation to policy objectives that are definite. Accordingly, from these generally accepted goals one may distil four objectives which flow from the mandates that are implicit in the Federal Reserve Act and the Employment Act of 1946. These are: to foster orderly economic growth; to sustain maximum employment; to protect the purchasing power of the monetary unit; and to keep international payments in balance—a main purpose of monetary policy for most countries even more than for our own. These objectives take on their full meaning if translated into human terms.

I think of maximum employment as job opportunities for a husband and father who has children of high school age who will be seeking employment in the 1960's when the number seeking a start in life will be twice as great as in the early 1950's. The kind of realism that would help to meet this family's need for job opportunities now and later requires keeping American firms competitive by turning out products that people want at home and abroad, and

¹⁶ Andrew D. White, *Fiat Money Inflation in France*, Privately printed for James Simpson, Chicago, 1933.

at prices they are willing and able to pay.

And the protection of the purchasing power of the dollar, I associate with the same worker and his wife, who will outlive him by eight years. In addition to Social Security, these two are among the 14 million with pension rights under private plans, the 40-odd million who hold government bonds, and the 112 million who carry insurance. These two hard-working people are savers, and both will be dependent upon savings.

Although even the four specific goals I have mentioned might receive general acceptance, it must be recognized that they represent plural objectives that may seem incompatible. For instance, certain nations, like England, have at times been forced to slacken their rate of domestic growth in order to balance their international payments. Moreover, there is considerable debate in this country as to whether the goals of full employment and stable prices are completely reconcilable. Most of the day-to-day problems in economic policy making, however, arise not out of differences as to objectives, but out of the choice of specific policies which will promote those objectives. It is at this point that confusion starts.

Unemployment, price stability, and economic growth have become subjects of popular debate. It is asserted by some that a stable dollar and enough economic growth to provide an acceptable level of employment are incompatible. It is my own conviction, however, that price stability is necessary for high employment to be sustained over any lengthy period. Perhaps our most urgent domestic necessity is to protect the purchasing power of the dollar while providing widespread employment opportunities. Both for the protection of those who live on fixed incomes, like pensioners and school teachers, and for the benefit of those who need steady

work to support themselves and their families, we must—as indeed we can—achieve high employment without inflation.

Employment levels

Inflation is not an effective long-run means of creating job opportunities. But on this point thinking is confused. A recent letter asked "How can industry expand, buy machine tools and provide jobs for us millions of unemployed when you guys create tight money? . . . Haven't any of you men got the guts to stand up for an expanding money supply and abundance of credit to encourage production and help make jobs?" A blunt answer to this heart-felt query is that the mere running of the printing presses, or the ballooning of bank credit, do not foster productivity improvement, and higher standards of living. Even when credit is under restraint, it usually is growing. The proper idea is to keep its growth in line with the possibilities of increasing the "real" output of goods and services. In other countries, and even in our own, highly trained ability has been diverted from producing goods to speculating on inflating prices. Speculative activity does create some employment to be sure, but not employment that lasts. Eventually inflation endangers and disrupts job stability for it is during inflationary booms that the seeds of deflation are sown.

Nor will inflation cure structural unemployment that stems from shifts in the use of resources. A dynamic economy forsakes the old for the new, and so one may expect rapid economic growth to bring about some unemployment of a structural sort. Even though further expansion will tend to put more people to work, an unemployment percentage higher than that reflecting frictional unemployment might lead to the question of whether job opportunities

would not be greater if certain prices were lower.

As expansion continues, the rising investment demand stemming from industrial research and management initiative requires an increased flow of savings. If we are to remain competitive at home and abroad, we shall need not only enough capital to implement technological advance, but competitive prices as well. Competition is, of course, a relative matter. How do our products compare with those of other countries as to quality, price, and promptness of delivery? While ours have improved, foreign-made products seem to have been improving even more rapidly. There is evidence that our cherished advantage in some types of machinery, as well as in autos and certain other mass-produced items, has been diminishing. This is a situation that will not be cured by ignoring it, or by the mere passage of time, or by passing laws. The sole solution lies in seeking continuous increases in technological and marketing efficiency, while preventing costs from rising faster than compatible with those increases. Only thus will our firms remain competitive.

Price levels

Prices were buoyant during the recent decline and subsequent recovery. In the recession, the industrial-price average fell only 0.6 per cent, though prices of crude materials slipped considerably. However, prices of farm products and foods went up sharply. As a result the total wholesale price index rose 1 per cent even while business was contracting. Since the turn-around in business activity in May 1958, the average of industrial prices has risen (as of July 1959) approximately 2 per cent above the previous all-time high. Average industrial prices have risen sooner and faster than in the two previous recoveries when prices did not advance at a

significant rate until after output had regained its previous peak.

Last fall Congress' Joint Economic Committee canvassed economists as to their views concerning the reconciling of unemployment with price stability. It sent questionnaires to members of 150 college economics departments. Replies were received to 615 of the questionnaires, or 40 per cent of the total number mailed out.

The first question read as follows: "Do you believe it feasible to achieve simultaneously both relatively high employment and relatively high stability of the general price level?" Of those responding, 60 per cent thought this achievement feasible even in the short run. Still a greater number, almost three-fourths, believed it possible in the long run. This expression of informed opinion indicates a widespread belief that there is no inherent conflict between these two types of economic stability.

No one expects all individual prices to be stable. Indeed, some movement of individual prices serves an essential economic function. In our market economy, it is the normal way of getting a proper distribution of scarce goods and the most productive allocation of resources. Stability of the over-all price level is, however, a clearly desirable goal to the extent that it is attainable. How stable, then, should one expect the price level to be?

Forty-four years have passed since the starting of the Federal Reserve System in 1914. If the consumer price index is used to measure price variability during this period, its annual fluctuations, both up and down, have been less than 3 per cent in 25 of the 44 years. This period, however, included some extremely large price changes, caused primarily by war financing and postwar readjustments. If we exclude the two World Wars and the Korean

hostilities, the 3 per cent standard was met in 24 of the remaining 31 years. Excluding these wars, the cumulative price changes since 1914 just about balance out. Dr. Roland I. Robinson has suggested to me that, without the influence of war, the current price level might not be far different from that prevailing about a half century ago. If all cyclical movements in activity could be avoided, we might then look hopefully toward a high degree of general price stability. However, as long as there are fluctuations in inventories or in business expectations or international crises occur, it is not reasonable to expect complete stability in the over-all price level.

What is damaging, however, is continued bias in price expectations. There has spread to consumers an acceptance of the notion that creeping inflation is inevitable. This notion already has been accepted by too many purchasers of common stocks and real estate and may have been overly influential in business policy making. It is itself a cyclically disturbing force. The risks of inventory accumulation in excessive amounts may seem abnormally small to businessmen if they feel certain that prices will rise. Thus one of the classic problems that has caused business instability is aggravated by lopsided price expectations.

GROWTH WITHOUT INFLATION

I turn now to rates of economic growth. Such rates, once of interest only to specialists, have now come under general discussion. The rates commonly cited, such as 3, or 4, or 5 per cent per annum, actually reflect two factors. One is the aggregate growth in economic resources, of which the principal one is population; the other is the increase in per capita productivity. While total growth since 1889 of $3\frac{1}{2}$ per cent per annum may correctly measure the increase in our capacity to fight

a war, the peacetime emphasis should be on per capita growth as the determinant of our standard of living and of our over-all well-being.

Healthy growth of the economy can be attained only by a close gearing of bank credit expansion with that of the economy generally. Such growth requires that the central banking system provide enough but not too much money to achieve and maintain balanced growth without inflation. Recent historical research of the National Bureau of Economic Research shows that, while growth rates have fluctuated considerably in the short run, the growth process, if measured by decades, has been remarkably durable. Except for the decade containing the Great Depression, we have had appreciable growth during every decade for the last seventy years. A highly significant point brought out by this research is that growth was strong during the period of falling prices in the last third of the last century. This evidence suggests that price stability and rapid growth are quite compatible. The essential point is that per capita growth depends to a considerable extent on improving productivity. Productivity, in turn, depends on the existence of a flexible economic system, one ready to use advanced technology.

In the private sector of the economy, the free choice of the consumer and the free choice of the businessman dominate the use of our resources, as they should. Consumers have been devoting a smaller proportion of their income to the purchase of products of factories, where statistical productivity gains have been great, and a larger proportion to services where there is no statistical measure of productivity. Repairs of cars and appliances, medical care, and travel have been a growing part of consumer expenditures. This shift from manufactured products to services, however, diminishes the statistical measure of

productivity increase. Moreover, since productivity in these services has undoubtedly improved, even though not measurable, the extent of their price rises has been exaggerated.

To sum up the argument thus far: inflation does not stimulate sustainable growth; it just creates a temporary illusion of it. Real growth requires that competition do its work both at home and abroad. Competition must be allowed to produce the kind of flexible change that brings out the maximum use of resources and does not allow inefficiency to hide behind the shelter of monopoly or other forms of protection. Rapid growth requires use of the most advanced technology. That which is inefficient and outmoded must be abandoned quickly. To employ some form of protection merely to preserve the status quo, whether through subsidies, tariffs, or featherbedding, tends to retard growth.

MONETARY AND FISCAL POLICY CAN SUCCEED

I shall now attempt to show that prudent financial housekeeping is possible under conditions worse than ours. In fact, there are some recent examples of how effective monetary and fiscal policy can be when they work together as a team. For instance, in Italy, 1947 marked a turning point in postwar financial and economic development. Prior to the introduction of the defense of the lire policy, Italy had been in the grip of a severe inflation. In a little over one year wholesale prices had risen by 150 per cent. The cost of living had doubled and paper money was being issued at a rate faster than the growth in national income. A new fiscal policy, in combination with a tighter monetary policy, ended this by (1) reducing the budget deficit to a level which could be financed by noninflationary means (through Treasury borrowing out of

savings, thus ending the resort to the printing press); (2) restraining the growth of credit to an amount consistent with the actual growth in real resources.

The effective contribution of Italy's stabilization program in escaping from its plight after World War II is indicated by the contrast between the doubling of the cost of living in about one year prior to 1947, and the 48 per cent increase in the entire decade that followed. Since the restoration of confidence in the currency, bank deposits have increased seven-fold. The real budget deficit, instead of being 140 per cent of revenue, was only 8 per cent of it in fiscal 1958, and the gold and foreign exchange reserves increased by nearly 700 million dollars. These reserves are now the third largest in Western Europe. Certainly if European countries such as Italy, Austria, and West Germany can overcome the ravages of war sufficiently to put their financial affairs in order, our own nation can achieve sound financial management. If it is to be achieved, however, those responsible for fiscal and monetary policies must overcome certain obstacles.

DIFFICULTIES OF MONETARY POLICY MAKING

Even if there is basic agreement as to the facts, they are not interpreted alike by all individuals. On occasions an increase in business inventories may appear to some as voluntary adjustment by businessmen in anticipation of rising production and sales, while to others it may appear to be an involuntary adjustment resulting from a falling off of sales. In the early phase of the present recovery, the slow growth of bank loans to business might have signaled to some that monetary policy was too restrictive, while to others it seemed to reflect high business liquidity and ample funds from internal sources.

Another problem of policy making is that many of the economic facts needed for policy formation are frequently unavailable, or become available too late. In the interim, it is necessary to rely upon "straws in the wind" obtained by word-of-mouth. Decision making within the Federal Reserve System faces the same difficulties as decision making in other areas, including the necessity of having to make decisions before the evidence is complete.

Finally, there are problems arising out of the need for monetary policy to be co-ordinated with Treasury financing. If we had the kind of fiscal policy sometimes hopefully and idealistically outlined in the textbooks, there would be no need to finance government deficits except in periods of low business activity. During such periods the financing of deficits creates no real problem for the monetary authority. Unfortunately, government deficits often have to be financed in periods of expansion—an unhappy fact that the Federal Reserve cannot ignore. In addition, the Treasury faces a continuing problem of refinancing the vast volume of securities maturing in the course of a year and of engaging in large borrowing and debt retirement operations to compensate for the uneven flow of tax receipts.

Monetary policy must take these heavy Treasury financing operations into account so that their success will not be placed in jeopardy. On the other hand, monetary policy must not be subordinated to fiscal policy. They must work as a team. A well-known example of the lack of such teamwork was the inflationary "pegging" of government bond prices after World War II.

Occasionally, the co-ordination of monetary and fiscal policies encounters difficulties of timing. For example, consider the problem posed for both the Treasury and the Federal Reserve when

the state of the economy called for raising the discount rate in the spring of 1957. For some months business confidence had been mounting. It was evidenced by a rise of industrial orders and of loans; by buoyant stock prices; by plant expansion; by a scarcity of steel, cement, and glass; and by higher material prices. The indicated discount change was necessarily delayed by Treasury financing activities in February, March, May, and July 1957. The Federal Reserve Banks, with the approval of the Board of Governors, finally raised their discount rates in August. This action that was needed for technical as well as economic reasons was delayed by these financing operations so that it came nearer the cyclical peak than would have been desirable.

Additional complications stem from the so-called "administrative lag" in the use of fiscal policy. Since it is necessarily long in the making and in the execution, it may exert an impact on business at just the wrong time to improve the latter's stability. In fact, governmental buying that was originally intended to be compensatory may actually be superimposed on a boom and further accentuate the demand that is distorting the economy.

INFLUENCE ON MONETARY POLICY OF FREE MARKETS AND FREEDOM OF CHOICE

The problems of monetary policy are the problems of a society organized around the principles of free markets and freedom of choice. In an economy where freedom is exercised by individuals and by business units, effective regulation of the money system is of prime importance. In fact, the major concern of monetary policy in such an economy is to minimize the unstabilizing effects of changes in the use of

money and credit that businesses and individuals generate in the exercise of freedom. But freedom, even though it entails flaws, is the well-spring of social and economic advance. It spurs the creative process; it permits experimentation leading to change. The resultant economic hazards are small prices to pay for the rewards.

In the field of credit, the government cannot compel any man to lend his money against his will—even to the government itself—in circumstances or upon terms not acceptable to him. This important freedom of the lender—matched of course by the freedom of the borrower to reject unacceptable terms—can have embarrassing results for the government, as happens when many investors abstain from purchasing government bonds.

Another freedom involved in determining policy is in the use of money itself. Those who hold cash balances may allow idle cash reserves to accumulate when interest rates are only moderately attractive. However when short-term interest rates are high, there is an incentive to economize in the use of cash balances. Increases occur in the velocity of money. Such an increase represents a legitimate exercise of economic freedom, but it complicates decisions as to what money supply is appropriate to sustain economic growth.

Still another economic freedom that has repercussions on the monetary system is the choice among inventory policies. The recession that began in the fall of 1957 was accompanied by rapid inventory liquidation. Indeed it continued after the bottom of the cycle was reached, but manufacturing inventories are now increasing rather briskly. The great buying or liquidating waves that flow from changes in inventory policy create a real challenge, not only for those concerned with monetary policy, but ultimately for individual businessmen themselves.

In brief, the problems that are the concern of monetary policy in a free society are those which flow from the exercise of freedom in the use of money. These problems are ever changing and no mortal can predict with certainty where they will lead. Accordingly, monetary policy can never be reduced to formulas or the application of routine adjustments to standard situations. It must continuously be modified to fit a changing economic environment. The Congress, in creating the Federal Reserve System, has designed an institution eminently suited to formulate monetary policy that is flexible. It is suited to the variety of our economy and to its changing moods. It recognizes that central banking is an art, or perhaps a craft, and not a science.

Inflation: Its Cause and Cure

By BERYL W. SPRINKEL

ABSTRACT: Despite widespread concern over inflation, prices have risen less since 1951 than in most past periods. The average annual rise in the price level has been about 1 per cent in the past eight years compared to 5 per cent to 8 per cent from 1946 to 1951 and 2.5 per cent to 3 per cent in the past half century. One of the major factors inciting inflation fears during the past year was the mammoth size of the fiscal 1959 federal deficit. Prices remained stable during fiscal 1959 because slack in the economy permitted production increases to equal spending increases. Inflation is caused by excessive increases in spending relative to the capacity of the economy to increase production. It is absolutely critical for the success of any program for the containment of inflation that management of the federal budget and monetary policy be designed to promote growth in total demands only so fast as the real economy grows. In particular, growth in the stock of money should be no faster, on average, than growth in production of goods and services. The Federal Reserve System has the power to control the stock of money and has used that power wisely since 1951. Budget policies have been less adequate. The informed citizen should urge support of flexible monetary and stabilizing budget policies.

Beryl W. Sprinkel, Ph.D., Chicago, Illinois, is Economist for the Harris Trust and Savings Bank, and Editor of Barometer of Business. Formerly Dr. Sprinkel taught at the University of Missouri and the University of Chicago. He has been a consultant on economic policy to the Federal Reserve Board, United States Treasury, and the Joint Economic Committee of the United States Congress. He has served as a member of the faculties of the Life Officers' Investment Seminar, Northwestern University Institute for Management and the Graduate School of Banking, Rutgers University. Dr. Sprinkel has contributed articles to various professional journals and is currently a member of the Economic Policy Committee of the United States Chamber of Commerce and the Research Council of the American Bankers Association.

THERE has been growing concern in recent months over the problem of inflation. Government spokesmen and financial writers comment on the subject frequently, and, as has been indicated in opinion polls, inflation is one of the greatest concerns of Americans today.

Before discussing the prospects for preventing inflation, a common understanding of the meaning of the term must be established. Inflation means to most observers a rise in the general price level of goods and services and will be so defined in this paper. The rising cost of maintaining a rising standard of living need not be inflation. Failure to distinguish between the cost of maintaining a rising standard of living and the cost of maintaining a constant standard of living is the source of much confusion. Only an increase in living costs in excess of the rise in living standards is inflation. Careful analysis of changing family budgets usually discloses that much of the apparent rise is due to better living—more and better food, clothing and shelter, as well as better automobiles and appliances, improved schools and other governmental services. A rising standard of living should not be feared and criticized but should be welcomed as the inevitable consequence of improving per capita production. In other words, much of the recent rise in family budgets is not due so much to the high cost of living as it is due to the cost of high living!

Nonetheless, the American consumer has suffered some inflation in recent years. The important question at this stage is how much inflation has occurred and how did the recent inflation pace compare with previous periods.

Inflation in this country is not new. It is something Americans have been accustomed to throughout most of the history of this country. The price rec-

ord in recent years, in fact, has been superior to most past periods. Since 1951, the average annual compound rate of rise in the consumer price index has been 1.3 per cent, while wholesale prices have risen at an average annual pace of 0.8 of 1 per cent. These increases were far less than the 5 per cent yearly rise in consumer prices from 1946 to 1951, and the 8 per cent annual rise in wholesale prices. The recent record also compares favorably with the past half century average annual rise of 3.1 per cent in the consumer price index and 2.3 per cent in the wholesale price index.

Although our price indices are superior to those existing in earlier periods, there is reason to believe that our present indices are biased upward. This bias is due primarily to inadequate adjustment for quality improvement in goods and services produced. Much of the apparent price rise was due to higher prices for merchandise of better quality rather than higher prices for the same goods and services. It is far from certain that any inflation has occurred on average in the past seven and one-half years if proper account is taken of the upward biases in the indices. The technical problem of adequate adjustment may be largely insurmountable since quality improvements over time are difficult to measure precisely. It is clear, however, that even though it may prove difficult, some further refinement should be attempted. If there exists a bias of as much as $\frac{1}{2}$ of 1 per cent to 1 per cent per year, no inflation has occurred since 1951. The extent of the bias is unknown, but it appears to be sizeable. In any event, the American economy has suffered a very moderate inflation, if any, since 1951.

SOURCE OF CURRENT INFLATION CONCERN

If it is true that recent inflation has been mild, why the current concern?

There are at least three factors that account for present apprehension. One is what appears to be a misunderstanding of the price performance in the recent recession. Many have argued that in contrast to previous recessions, prices did not decline in 1958. The facts are that prices typically did not decline in past recessions. Prices declined in this century only during depressions of which there have been three really serious ones: 1920-21, 1929-33 and 1937-38. In those three periods, declines in the consumer price index ranged from 5 per cent to 25 per cent. In the early part of most recessions prices rose moderately and then leveled out. Also, in the early months of the three contractions, which eventually became depressions, prices rose. The recent experience was in line with past performance—a modest rise in the early phase of the recession followed by a level trend. Those contending the recent pattern was unique are misreading history. If the late recession had deepened into a depression, prices would have dropped. Fortunately, antirecession measures were adopted promptly, and the economy is now enjoying vigorous growth.

Another reason for the current great fear over inflation is the widespread belief that the recent bull market trend in stock prices bears no relation to previous trends. There are always some differences in market developments over recession-recovery periods, and there are differences this time. But the stock price pattern experienced during the recession and early recovery periods was in line with usual trends. Typically, stock prices turn up before business activity improves. The average lead of stock prices over the business recovery is about seven months. In the recent recovery the stock price trend led five months. The National Bureau of Economic Research has pointed out that there tends to be an inverse relationship

between the size of the stock market rise following recessions and the size of the preceding recession.¹ The greater the drop in economic activity, the smaller the subsequent rise in the stock market in the first and second year of recovery. The smaller the drop in economic activity, the greater the rise in stock prices in the first and second year of recovery. The recent performance was on schedule. The stock market rise in the first year of recovery from the low of the recession was greater than the rise occurring in the same time period following the next most severe recession, but it was less than the rise in the stock market following most milder recessions. To the extent that the recent bull market in stocks is inciting inflation fears, the concern is ill founded.

Perhaps the major factor increasing inflation concern was the approximately 12.5 billion dollar federal cash deficit in the past fiscal year—the largest peacetime deficit in our history. All of us have learned that a deficit inevitably causes inflation. Yet, that answer is too easy. A deficit causes inflation when two conditions hold. A deficit is inflationary if: one, it is financed by new money obtained from banks. Only a small amount of the cash deficit in fiscal 1959 was bank financed. Two, the economy is functioning at practical full employment of resources. The economy had substantial unemployment during the past year. Although current concern about future inflation appears to be at an all-time high, it is interesting to note that general price indices have been almost perfectly stable for over a year despite the mammoth deficit.

In summary, it has been possible over the past year and a half to substantially

¹ Geoffrey H. Moore, "The Behavior of Business Indicators in a Recovery Period," *Evaluating and Using Business Indicators*, American Management Association Report No. 25, 1959, pp. 17-21.

increase total spending without inflation since the economy had room for expanding production. Production rose just as rapidly as did spending.

IS FEAR OF LONG-RUN INFLATION ILL FOUNDED?

Do the preceding comments mean that we should not be concerned over the long-run danger of inflation? Certainly not! There are good reasons why concern is justified. The Employment Act of 1946 and the philosophies of both major political parties provide considerable assurance that prolonged depressions will not be permitted to develop. Yet, it was only in periods of prolonged depressions that prices declined in the past. In effect, a "floor" has been placed under the general price level. It therefore becomes critically important that a "lid" be established on the general price level if long-run inflation is to be prevented. Stabilization of the general price level need not mean fixed prices for particular goods. It is only through fluctuations in relative prices that a growing economy responds to the changing demands placed upon it. Those that argue for government investigation and regulation of price and wage changes would place a straitjacket on the American economy which would make it impossible to secure the optimum allocation of resources. It would be indeed unfortunate if concern over maintaining price stability resulted in more, rather than less, government intervention in the pricing process. The existence of a practical "floor" under the general price level does mean that the avoidance of inflationary pressures should become a major factor influencing the formulation of future government economic policies.

CAUSES OF PAST INFLATIONS

What are the causes of inflation? The cause of all inflations in this country

has been excessive spending relative to the capacity of the economy to increase production. It is absolutely critical for the success of any program to contain inflation that management of the federal budget and monetary policy be designed to promote growth in total demands only as fast as the real economy grows. There is perhaps no empirical regularity among economic data that is based on so much evidence for so wide a range of circumstances as the connection between substantial changes in the stock of money (demand deposits plus currency) per unit of production and the level of prices. The Federal Reserve System has the power to control the stock of money through its monetary policy actions. In the main, Federal Reserve policies, since the 1951 "accord" was achieved, have been of a stabilizing nature. The key to preventing future inflation lies in limiting growth in the money supply to the pace of real economic growth.

Some say that we must have inflation if we are to achieve maximum economic growth. Yet two recent independent and careful studies by Bach and Friedman concluded there was no apparent relation between the rate of inflation and the rate of economic growth in previous periods in this country.² During some periods substantial growth occurred without inflation and during other periods substantial growth occurred with inflation. There was no apparent consistency between rate of growth and the rate of inflation.

² G. L. Bach, "How Important Is Price Stability in Stable Economic Growth?", *The Relationship of Prices to Economic Stability and Growth*. Compendium of papers submitted to the Joint Economic Committee of the United States Congress, March 31, 1958 (Washington, D. C.: United States Government Printing Office, 1958), pp. 33-48. Milton Friedman, "The Supply of Money and Changes in Prices and Output," *ibid.*, pp. 241-256.

PREVENTIVES FOR FUTURE INFLATIONS

Let us turn for just a moment to the means for encouraging economic growth. Achievement of adequate growth requires a continued high level of investment and more efficient use of existing resources. More attention could usefully be devoted to revising the tax system to encourage investment and hence increase productive potential. Also, our nation can no longer afford such wasteful luxuries as the farm support program, uneconomic regulation of transportation rates, federal support of retail price maintenance, high tariffs, and permissive policies toward featherbedding practices of unions. Government efforts should be designed to reduce artificial barriers to the flow of labor and capital from less to more efficient lines, rather than the reverse.

The Federal Reserve System currently has the power to control the stock of money through its monetary policy actions. Yet, strong pressures are now developing in many circles for eliminating the power of the Federal Reserve to restrict credit when inflationary pressures exist. If a flexible money policy is abandoned, substantial long-run inflation is inevitable. Federal Reserve powers in recent years have been used to restrict credit in times of full employment when inflationary pressures increase and to encourage monetary growth during recessions. Since the adoption of this type of policy in 1951, prices have been more stable than in most earlier periods in our history, and a high level of employment has been maintained most of the time. The recent record was not an accident. It was very closely related to the fact that monetary policy has been vastly improved.

The rate of growth in the money supply is clearly correlated both to peri-

ods of boom business and recession.³ Prior to every recovery, including the last one, a rise in the rate of monetary growth occurred, and prior to every recession there has been a decline in monetary growth. The data strongly suggest that the relation is a causal one.

Present monetary policy is much superior to previous policies from an anti-inflation and economic stabilization point of view. However, there are probably further improvements that can be made. It is not accidental that in the past fifty years, the three periods when the most violent declines in the rate of monetary growth occurred preceded the three worst depressions. Also, periods of rapid and sustained monetary growth have been inevitably followed by inflation once the economy attained practical full employment. At present, extreme fluctuations in monetary growth are avoided, and this practice should continue. Monetary policy must be tied to sensitive action guides. In the past the Federal Reserve sometimes used the consumer price index as a major guide to action. That was probably a mistake because the consumer price index moves upward after business activity starts down, and it continues to be level long after inflationary pressures begin. Monetary policy must be tied to sensitive indicators rather than laggards such as the consumer price index.

Need to balance the budget

It is important, from an anti-inflation point of view, that the fiscal 1960 federal budget be balanced. A small bank-financed deficit in fiscal 1960 would be much more inflationary than was the mammoth deficit of fiscal 1959. The reason is simple. Bank-financed deficits

³ Beryl W. Sprinkel, "Monetary Growth as a Cyclical Predictor," *The Journal of Finance* (September, 1959).

stimulate total spending. As long as labor and capital resources are idle, sharp increases in total demands are matched by equally sharp increases in production. Once practical full employment is achieved, production increases will be moderate. Unless demand increases are also moderate, inflation will result.

The federal budget automatically exerts a stabilizing impact over the business cycle due to "built-in" stabilizers. Federal revenues decline in recessions due to the drop in personal and corporate tax liabilities. With no change in spending, a deficit emerges. Actually, transfer payments such as unemployment compensation payments and certain social security payments tend to rise during recessions, thereby increasing the size of the deficit. As business activity improves revenues rise and transfer payments decline thereby reducing the stimulus from the federal budget. Direct federal spending programs initiated by Congress during a recession frequently exert a destabilizing influence due to the lags between the formulation of the program and the eventual outflow of money.

The recent deficit played a beneficial role in stemming the recession. Federal revenues are now rising rapidly as personal and corporate incomes increase. Unfortunately, some of the spending programs initiated during the recession are now getting under way and will increase the difficulty of balancing the federal budget in the coming fiscal year.

Legislative decisions as to the size of the federal budget should be based primarily on the relative efficiency of the federal government versus state and local government and private enterprise in performing the service under consideration. From an inflation-control point of view, it becomes critically important that federal revenues at least equal expenditures during prosperous periods so

that deficit financing may be avoided. Tax rate reductions during prosperous periods are consistent with inflation control only if a surplus results from a reduction in federal spending or growth in the economy which automatically increases tax receipts.

In summary, the budget should be at least balanced during periods of full employment and a deficit should be welcomed during recession periods. A budget surplus is desirable in the period immediately ahead.

In addition to continuing a stabilizing monetary-fiscal policy, the objective of attaining stable prices would be enhanced by an amendment to the Employment Act of 1946 to include the goal of price stabilization as an equally important objective of government as the current goal of maximum employment and production. As of now the emphasis of the Employment Act of 1946 is primarily on maintaining maximum employment and production. This Act does not emphasize price stabilization. If the Employment Act were amended to include price stabilization as one objective—not the most important, but equally important—the Act would give clear direction to responsible government agencies when formulating economic policies. Also, such an amendment would tend to stabilize price expectations in the private sector of the economy.

There is no convincing evidence that direct wage and price controls would stop inflation. Such controls do not affect the cause of inflation but merely affect the symptoms. Direct wage and price controls neither increase the productive capacity of the economy nor do they limit final demands. Therefore, they cannot prevent inflation. Furthermore, direct controls are inconsistent with a free enterprise economy, for controls prevent adjustment in production patterns in response to changing de-

mands by consumers, businesses, and governments.

ACTION PROGRAM FOR INFORMED CITIZENS

What can the intelligent citizen do to further the cause of price stability? Unfortunately, the basic causes of inflation are beyond the direct control of the individual. Admonitions to individuals to save more, buy more savings bonds, spend wisely, avoid excessive wage increases, join buyer's strikes, and so on, are destined for failure unless a stabilizing budget and a flexible monetary policy are pursued. If these policies are adopted, such admonitions are neither necessary nor beneficial. Within the limits established by custom and law, individuals should feel free to make spending and saving decisions based on their own personal needs rather than upon the impact their action may have on the economy. It is the responsibility of the Executive, Congress, and the Federal Reserve Board to follow policies which will restrain total spending during inflationary periods and hence provide assurance that free private choice will be consistent with the public good.

But ultimately governmental authorities must be responsive to public opinion. It is the obligation of an intelligent citizen to first make sure his opinion is an informed one, and second to communicate his opinion to his elected representatives. It is critically important that the present Administration and Congress understand that the public fears inflation and wants price stability. A balanced budget in fiscal 1960 would contribute to that goal.

Also, it should be recognized that the Federal Reserve System is ultimately responsible to Congress. Although virtually no one objects to easy money during periods of recession, many legislators, as well as others, fail to see the necessity for pursuing a restrictive monetary policy during boom periods. The reason for this attitude is clear. No one likes to defer spending plans because of the unavailability of money. Yet, if all borrowing demands during boom periods were accommodated by the creation of new money, the production of goods which satisfy wants and services would not be increased, but prices would rise. Congress should be informed that the pursuance of a flexible monetary policy is critically necessary if further inflation is to be avoided.

APPENDIX

The Need to Check Inflation

STATEMENT BY THE PRESIDENT
IN MAKING PUBLIC THE INTERIM REPORT OF THE
CABINET COMMITTEE ON PRICE STABILITY FOR ECONOMIC GROWTH

June 29, 1959

The Interim Report submitted to me by the Cabinet Committee on Price Stability for Economic Growth, of which Vice President Nixon is chairman, contains recommendations for checking inflation that are important to all Americans. I am therefore making the Report public and sending copies of it to all members of the Congress. I urge that the Congress consider anew the Committee's three recommendations, all of which require legislative action. Each of these recommendations has been previously submitted by me to the Congress.

The Committee is continuing its work and will issue statements from time to time to inform the public on questions related to economic growth and price stability. A sound public understanding of the facts bearing on these questions is needed if we are to find constructive answers to them.

DWIGHT D. EISENHOWER

INTERIM REPORT TO THE PRESIDENT

By Cabinet Committee on Price Stability for Economic Growth

It is the unanimous opinion of the Cabinet Committee on Price Stability for Economic Growth that our economy is now at a critical juncture urgently requiring action to forestall inflation and insure sound and sustained economic growth and progress.

It is the purpose of this interim report to give an appraisal of the current state of the economy, to make recommendations for immediate action which we believe is essential if inflation is to be checked, and to indicate those areas to which the Committee is presently directing its studies for the purpose of developing long run, positive recommendations to increase efficiency and pro-

ductivity and thereby assure maximum economic progress.

Current state of the economy

The economy has recovered from the recent recession and is now breaking into new high ground. Though unemployment persists in some areas and industries, the evidence of recovery is unmistakable:

. . . Overall output is the highest in history and rising vigorously.

. . . Employment is rising sharply and unemployment is falling steadily.

. . . Average weekly earnings, personal consumption expenditures, and

private investment are at record levels and are continuing to rise.

Threat of inflation

For more than a year the average prices of the things families buy have been remarkably stable, but the Committee has reached the conclusion that our ability to maintain reasonable price stability will be seriously threatened unless affirmative action is taken now. Danger signs that cannot be ignored are:

. . . Prices of industrial commodities and many other goods have been rising in wholesale markets and this is usually followed by rises at retail.

. . . While the average level of consumer prices has been relatively stable, prices of many consumer goods and services have continued to go up in the past year.

. . . The multi-billion dollar Federal deficit of the budget year just ending (fiscal '59) is creating sizable inflationary pressures.

. . . While prospects for holding the line on expenditures for the budget year just starting (fiscal '60) appear much brighter than they were before such wide and strong public support developed in the fight against deficit spending, there still remain strong pressures for irresponsible spending. To yield to these pressures, either through appropriations for next year or through authorizations for later years, would create serious inflationary forces. The Committee has noted an alarming tendency in the Congress to work toward only an illusory balance in the budget, by substituting for current appropriations commitments for later years which will make it exceedingly difficult to avoid future deficits.

. . . There are strong tendencies toward increased spending by State, county, and local governments.

. . . Wage settlements have been made recently which raised wages substantially; wage agreements negotiated in earlier years provide for increases in rates this year; and wage agreements to be negotiated this summer or autumn in many industries (steel, aluminum, other metals, construction, rubber, lumber, railroads, paper, longshoring, meat packing, and metal containers are among them) could result in wage increases of such magnitude as to lead to price increases.

The choice before us

We are confronted, in summary, with overwhelming evidence that we have arrived at a time of decision as to the future course of our economy.

The Committee's conclusions can be stated in two sentences:

. . . We face a serious risk of price increases which not only would be directly harmful to American families but would seriously endanger the healthy prosperity now developing.

. . . If, on the other hand, inflationary forces are substantially checked, we can move forward into the greatest and soundest period of economic progress and prosperity in history—a period of sustained economic growth with reasonable price stability.

Effects of inflation

The Committee rejects three misconceptions that are sometimes heard:

- . . . that a small amount of inflation is no cause for concern;
- . . . that inflation will stimulate economic growth;
- . . . that "a little inflation is inevitable, relax and enjoy it."

Moderate price rises in the period of vigorous economic expansion which is now well under way would not be cause for alarm if these price rises were sim-

ply offsetting declines in the recent recession. In the recent recession, however, there was no decline in the overall average of prices. The record shows, in fact, that for the past quarter of a century the price increases which characterize periods of rising prosperity have not been offset at other times. Thus, moderate increases even for short periods cumulate in the course of years to immoderate increases in the cost of living.

Increases in the cost of living

... Inflict unjust hardships on the many families whose incomes or pensions are fixed in dollars, or do not rise in proportion to prices.

... Violate our standards of fair play by harming families whose incomes are average or below-average more than families whose incomes are above average.

... Contradict promises implied when people put aside income in insurance, government bonds, retirement funds, and other forms of saving; for when the money is returned it fails to buy the goods and services that people were led to expect when they put the income aside.

Resistance to inflation is bound to cause temporary inconvenience to some and to limit the gains of others, but price stability will powerfully promote the welfare of all.

Fallacies of price and wage control

The Committee rejects government control of prices and wages as a method of controlling inflation. Such controls would not only fail completely to achieve any good but would do more harm than any amount of inflation that we have ever experienced or are likely to experience in peacetime.

While reasonable stability of the *average level* of prices is desirable, vari-

ability of *individual* prices is essential, because that controls the efficiency and the progress of our dynamic economy. Differences in prices reflect the priorities attached by consumers to different products; they thereby guide productive efforts, which seek the best returns for their effort, into useful activities. Differences in prices show the scarcities of different raw materials, machines, and personal skills, and thereby induce managers, who seek to produce at least cost, to use methods and materials which are most abundant and to conserve those which are most scarce.

If prices are regulated they cannot reflect accurately the relative priorities of various goods and services, or the relative scarcities of various means of producing goods and services. The result will always be—as history shows clearly that it always has been—waste, inefficiency, and slowing down of progress.

Furthermore, price control inevitably leads to wage control. The two together inevitably lead to rationing goods and regulating jobs and working conditions. The resulting loss of freedom would ultimately prove even more disastrous than the loss in living standards.

Recommendations for immediate action

There is no panacea, no easy way, to control inflation. As a minimum course of action to meet the problems the Committee recommends that the following steps be taken promptly:

(1) The Congress should make it clear that the Federal Government intends to use all appropriate means to protect the buying power of the dollar. Recognition by the Congress of reasonable price stability as an explicit goal of Federal economic policy was proposed in the State of the Union Message last January and repeated in the Economic Report. The Congress should give the highest priority to this pro-

posal. By speaking out clearly on this issue during this session it can effectively support the Administration and the public in the fight against inflation.

(2) Not only is it imperative that the budget be balanced in the fiscal year starting next month, but it is important that the national debt be reduced. Any effort to increase expenditures beyond the levels recommended in your budget should be vigorously resisted. Holding the line on expenditures, together with improved revenues from prosperous business conditions, would make possible some reduction of the debt. Not only must the line be held on the total of next year's appropriations, but it is important that the greatest restraint and selectivity be exercised in authorizing programs for later years. Excessive authorizations, by making deficits or higher taxes likely in the future, could create permanent inflationary forces.

(3) Without firm control of the quantity of money and credit, all other measures to check inflation will be futile. Sound monetary policy requires that the Federal Government avoid making its bonds, other than those of comparatively small denomination designed for family savings, the equivalent of money. Government bonds are the equivalent of money if they can always be changed into actual money at virtually face value, not only when they are due and payable but any time before. This is the case if the Treasury is forced to issue only very short-term bonds, or if the Federal Reserve System stands ready to buy at a pegged price all government bonds offered to it in advance of the date when they are due to be paid by the Treasury. There is only an imperceptible difference between the government's issuing bonds that are equivalent to money, and the government's just cranking up the printing presses and rolling out greenbacks. The

government will be forced to continue issuing large additional amounts of short-term bonds that are the near-equivalent of money until the Congress allows the Treasury sufficient flexibility to achieve a balance in our debt structure by inducing people of their own free will to invest their savings in long-term government bonds. Thus, to avoid inflation it is essential that the present limitation on the interest rate on long-term government bonds be removed, as the Administration has already recommended. The issue is whether we want price stability or whether we want, in a concealed way, to do the equivalent of printing money—something the American public would not stand for if done openly.

Actions needed to promote economic progress

The preceding three steps are direct defenses against the present danger of excessive price rises. The Administration has already recommended all of them to the Congress. We emphasize them in this Interim Report because these actions are needed without further delay.

In the long run, however, the most effective antidote to inflation is increased efficiency and productivity of the economy. This is one of the reasons why a major part of our work is directed toward actions to promote sustained economic growth. Furthermore, such growth is necessary for maintaining our increasing standard of living and our national security.

Among the subjects on which we are working because of their importance to the efficiency and productivity of the economy are:

... *Tax reform.* A certain amount of revenue raised in one way may interfere far more with efficiency and productivity than the same amount raised

in another way. Some taxes make it profitable for people to devote energy and ingenuity to avoiding tax liabilities, rather than to devote their efforts to doing the most useful things they can in the most efficient ways. Tax reforms are needed to promote economic growth. The "time in the foreseeable future when needed tax reforms can be accomplished," to which you looked forward in your State of the Union Message, can perhaps be realized soon; for, if the line can be held on the Administration's budget, tax revenues should more than meet current expenditures. This will provide the margin needed to provide for reduction in the debt and absorb any temporary losses of revenue caused by shifting to rates which, by improving incentives, will enlarge the tax base. Studies are now under way with a view to proposing changes in our tax laws at the appropriate time.

... Our competitive position in foreign markets. A significant part of our total employment depends on exports. If we price ourselves out of foreign markets we price ourselves out of jobs, and our prosperity and economic growth will be hampered. Several government agencies are studying this problem, including the Departments of State, Commerce, and Labor, the Federal Reserve Board, and the Council of Economic Advisers. On the basis of these and other studies the Committee will issue a report with recommendations.

... Government regulations affecting industry. Many government regulations, formulated by regulatory agencies, by administrative agencies, or by legislation, were originally established under very different conditions to protect the public against exploitation that is now virtually eliminated by technological developments. Some of these regulations have costly side effects, by seriously reducing productivity or causing inefficiency. There is need for a

thorough review looking toward elimination of regulations which retard economic growth. Several studies have been initiated to explore the modifications needed to encourage economic growth.

... Farm price support programs

Under existing obsolete laws, price supports on a few favored crops are inflationary through their enormous costs. They also contribute to raising the prices that consumers must pay for food and for goods made from agricultural raw materials. Our export subsidies required by law handicap our own industries by making American-grown raw materials available more cheaply to foreign competitors than to American manufacturers. The expenditures of the programs go largely to comparatively few large producers, and to industries only remotely connected with farming. The Committee will conduct special studies leading to recommendations for changes designed to alleviate the major inflationary effects of existing programs.

... Practices of labor and business.

Excessive concentration of power in the hands of labor or business results in practices which are contrary to the public interest. Such practices reduce efficiency and productivity, and they create inflationary pressures. Remedies for these practices should be sought through eliminating the power to injure the public interest, rather than through public control or review of the decisions of businesses, of unions, or of collective bargaining. The Committee will examine and report on the extent to which concentrations of power in labor and business contribute to inflation or impede economic progress.

... Public understanding. One of the functions assigned to this Committee in the State of the Union Message is to "strive to build a better public understanding of the conditions necessary

for maintaining growth and price stability." As part of our work on that assignment we shall from time to time issue reports on various facets of the broad problem of economic growth and price stability.

Respectfully submitted,

Cabinet Committee on Price Stability
for Economic Growth

Richard M. Nixon (*Chairman*)
Vice President

Robert B. Anderson
Secretary of the Treasury

Arthur E. Summerfield
Postmaster General

Ezra Taft Benson
Secretary of Agriculture

Lewis L. Strauss
Secretary of Commerce

James P. Mitchell
Secretary of Labor

Raymond J. Saulnier
Chairman, Council of Economic Advisers

W. Allen Wallis (*Executive Vice Chairman*)
Special Assistant to the President

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INTERNATIONAL RELATIONS

HOLBERT N. CARROLL. *The House of Representatives and Foreign Affairs*. Pp. xviii, 365. Pittsburgh: University of Pittsburgh Press, 1958. \$5.00.

Dr. Carroll, an Associate Professor of Political Science at the University of Pittsburgh, has done a painstaking scholarly job. The Foreword by Dr. William Y. Elliott of Harvard could hardly be bettered as a "book review" by another qualified historian. My comments, therefore, may be taken as those of a private soldier who served in these wars and who is thankful to this war correspondent for placing in perspective that which was obscured by the dust of battle and "The Fog of War." I venture, as a fellow author, to express respectful appreciation of the research in depth required to make this book possible.

The author has caught, with a sense almost tactile, the changing kaleidoscopic moods of the Congress. He has detected, too, the gradations in the quality of committee leadership during successive Congresses. One would like to hear his private opinion of some of the members of the House as to their capacities for good or ill.

There is much of interest in this book concerning a matter not well understood by the politically unaware. I mean the acceptance of the necessity for bipartisanship in the creation or annotation of foreign policy. Partisan interplay and bloc

interests are also discussed in some detail, but one notes and agrees with the considerable differentiation between bipartisanship in committee work and the necessitous descent into the political Avernus on the House floor.

This book is rarely marred with factual errors. One notes, however, on page 18, the statement that, in 1938, "Congress voted not to fortify Guam." Here, the author unwittingly perpetuates an ancient canard of the political forum. This was a bill to deepen a harbor in Guam to facilitate the approach of commercial seaplanes. This is an excellent example of a false charge, so frequently repeated, as to lull the researcher into accepting it as factual.

The author's thesis that the House Appropriations Committee has been more effective than the Foreign Affairs Committee in the area of foreign policy administration, as distinguished from foreign policy, seems to me to be well taken. In comparing the impact of the Appropriations Committee and the Foreign Affairs Committee on executive agencies, particularly the State Department, the author astutely observes that "it is often wiser to please the money committee than to placate the legislative committee which authorized the policy, if the two do not agree."

The operations of other committees, as they affect foreign policy, are knowledgeably discussed. Much research is evident in highlighting the influence of such com-

mittees as Agriculture, Interstate and Foreign Commerce, and Merchant Marine and Fisheries. The attitude of the House toward its powerful Rules Committee—half grudging resentment and half gratitude for suppression of politically embarrassing legislation—is interestingly discussed.

One notes some examination into the work of conferees with the Senate committee conferees, the operation of joint committees of both Houses, and of channels of House-Senate co-operation. A full development of this interrelationship would require another book. This reviewer eagerly awaits it.

HUGH SCOTT

United States Senator from
Pennsylvania

PERCY E. CORBETT. *Law in Diplomacy*. Pp. xii, 290. Princeton, N. J.: Princeton University Press, 1959. \$6.00.

In a Preface the author states that "this book proposes to study and in some degree measure the influence of legal notions on foreign policy without assuming or elaborating a system of international law . . ."

The study is centered around the foreign policies of Great Britain, the United States, and the Soviet Union. Actual illustrations and case studies are taken from the diplomatic history of these countries. Criticisms are made in many cases where the author sees discrepancies between politics and law.

In "The Soviet Dilemma," Chapter III, credit is given to Czars Alexander II and Nicholas II, respectively, for initiating the Brussels Conference of 1874 and the First Hague Conference of 1899. But for the Soviets "the emphasis is sharply upon international law as a tool rather than as an objective system of control" (p. 101). The Soviet government is strongly criticized for "the savage suppression by Soviet arms of Hungary's tragic struggle for free government in the autumn of 1956" (p. 103).

In a lively discussion of "Mare Clausum and Mare Liberum," Chapter IV, there is included a splendid account of the development of the three-mile limit. In view of

conflicting national claims the freedom of the seas "is still as remote as the vigorous world government which could alone give it reality" (p. 135). In "The Diplomacy of Arbitration," Chapter V, national restrictive and limiting influences hamper more complete jurisdiction of arbitrators and courts. As to Russia its policy has shifted from the days of the czars when it actively supported the practice of arbitration to the present when Moscow "wishes not only to avoid any obligation to arbitrate, but, if it should participate in arbitration, to preserve its discretion at each stage of the proceedings" (p. 171).

In "International Organization," Chapter VI, the various disputes handled by the League of Nations and the United Nations are discussed. Here again the pull and tug between politics and law is noted in the accounts. The author sees some hope in the work of the various functional international agencies. In "Human Rights and World Community," Chapter VII, note is taken of how the cold war is reflected in national viewpoints on human rights. As "between the Soviet Union on the one hand and the United States and the United Kingdom on the other, there is no doubt in most Western minds where the greater solicitude for the liberties and opportunities of the individual resides" (p. 263).

By way of some general conclusions the author recognizes that some progress has been made "toward acceptance and improvement of modes of settling disputes." But these "forward steps do not mean that we are within sight of an effective world community with its necessary general submission to law and collective monopoly of force . . ." (p. 271).

This is a very thought-provoking book, filled with vigorous language which does not stop at criticisms of national policies. There is much useful, well-documented material which defies brief review but warrants careful study. One may hope that the notable lines of divergence between politics and law so sharply delineated by Professor Corbett will be progressively lessened as peoples everywhere sense, with increasing clarity, the relationship between international law, human rights, higher

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J. EUGENE HARLEY

Professor of Political Science
University of Southern California

JAMES P. WARBURG. *The West in Crisis*. Pp. 192. Garden City, N. Y.: Doubleday & Company, 1959. \$3.50.

Mr. Warburg continues his notable public service with this latest of his valuable books which may fairly be called Tracts for our Times. It is, he says, "a book prompted not only by deep concern but by a feeling close to despair—despair on the part of one who is enough of an optimist to believe that man was not put upon this earth merely in order to destroy himself." This feeling, the present reviewer owes it to you to confess, he fully shares as he shares Mr. Warburg's general point of view on what should be American policy, especially in the realm of foreign affairs. The book is so timely that it contains a sympathetic note on Mr. Dulles' fatal illness and supplementary notes bringing the chapter on the 1958 crises and prospects for disengagement down to the Berlin crisis. Here Mr. Warburg includes his valuable interpretation of the Quemoy-Matsu Crisis—which was not solved but only sleeps—and the letter to the State Department and senatorial leaders suggesting the lines of a reply to the Soviet government's note of November 27, 1958 on Berlin.

These immediate approaches to pressing problems are by no means improvisations; they spring from the settled convictions of an experienced observer on the proper basis for a Western, and more especially, an American policy. He examines threats to "Capitalism" and soft spots in the American economy. He discusses disarmament and disengagement, examining both as they should be examined as necessarily complementary. He is guided in his positive suggestions by his conviction that our difficulties largely arise from a dilemma which he describes as follows: "The government of the United States has not yet fully adjusted its foreign policy to the fact that the United States is no longer, as it was for a short moment of history, the para-

mount power and that, therefore, it can no longer police the world or dictate the conditions of a peaceful settlement. . . . That, in the opinion of this observer, constitutes one part of the basic dilemma of American diplomacy in the second half of the twentieth century. . . . The other part of the dilemma is that the government of the United States has not adjusted its policy to the drastic change which has taken place in the nature of physical, economic, and psychological power" (pp. 82–83).

Space prevents even a summary of Mr. Warburg's development of this theme and his positive recommendations. They can be found very clearly stated in this book, among whose excellences succinct brevity ranks high.

NORMAN THOMAS

New York City

LOUIS J. HALLE. *Dream and Reality: Aspects of American Foreign Policy*. Pp. xxi, 327. New York: Harper and Brothers, 1959. \$3.75.

In 1955, when Louis J. Halle published *Civilization and Foreign Policy*, his objective was the development of an "applicable body of theory" for guidance in United States foreign policy. His latest book has quite a different objective. The title, *Dream and Reality*, epitomizes the conflict inherent in our foreign policy. In his own words: "We Americans have constantly dreamed of isolation and have repeatedly experienced involvement. We have dreamed of security behind our watery ramparts only to awaken belatedly, time and time again, to the approach of danger across those very seas to which we have confided our protection."

During the interval since his earlier book Mr. Halle has apparently come to believe that until certain basic changes in America's interpretation of its place in the world occur, it is premature and perhaps even irrelevant to think about a theoretically based foreign policy. The purpose of this book, then, is clearly that of correction and reorientation; *Dream and Reality* instead of being a sequel to *Civilization and Foreign Policy* is precedent to it in conception and design.

The author's main thesis is that from the Monroe Doctrine in 1823 until 1947, when the Truman Doctrine signalized a realistic about face, United States foreign policy was postulated upon a legendary rather than a factual conception of the world and our relation to it. In developing his argument, Mr. Halle observes that the demands of diplomacy place a high premium upon sophistication, judgment, and skill in reconciling the "strategic" and the "ideological" aspects of any issue. He uses these terms to distinguish between a realistic pursuit of a national security interest and a program grounded mainly on popular appeal.

Mr. Halle's theme is not new but seldom has it been more persuasively advanced. His technique of arguing his case by reviewing some of the pivotal decisions that have shaped our foreign policy conveys a sense of reality that carries marked impact; he has conceived his task shrewdly and executed it with skill. On first reading, the book gives the impression of unevenness, poor coherence, coverage that is both spotty and discursive. All of these things may be true, but they do not destroy the general effectiveness of his presentation. He does not pretend to tell the whole story of American foreign policy; rather he employs the case method and succeeds in preserving the integrity of both his method and his subject matter.

LAWRENCE H. CHAMBERLAIN

Professor of Government
Columbia University

EUGENE M. EMME. *The Impact of Air Power: National Security and World Politics*. Pp. xiv, 914. Princeton, N. J.: D. Van Nostrand Company, 1959. \$12.50.

It is difficult to dissent from the judgment of the distinguished reviewers quoted on the dust cover of this book, that Dr. Emme has furnished teachers and students of military affairs with an invaluable aid in their little documented studies. He has presented a nine-hundred page collection of documents on the doctrine of air power, ranging from tentative prophecies in the first decade of this century to the confident prognostications of the astronautic experts of our own day. Within his range he comprises such historic and recondite ma-

terial as Winston Churchill's "Air Defence Memoranda of 1914"; the report of the Smuts Committee of 1917, which made possible the creation of the Royal Air Force and all other independent air forces which followed it; declarations of faith by Goering, Trenchard, Mitchell, and Severisky; expert analyses of the role of air power in the Second World War; a wide selection of documents on nuclear warfare and the theory of deterrence; a useful group of statements, Russian and foreign, about the evolution of Soviet air policy since the Second World War; and an extremely useful selection of speeches and writings by the principal protagonists in the great debate on American defense policy which has raged during the past ten years. To each section is added a reading list of relevant books and articles which will be invaluable to teachers of a subject whose bibliography is still hopelessly unorganized. It is, in short, difficult to exaggerate the value of this work.

In view of this value, criticism seems churlish; but certain criticisms must be made. The first is that in this book Dr. Emme is insufficiently critical, especially in his selection of contemporary documents. More than four hundred pages are devoted to quotations from documents on postwar defense policy. Much of this material is redundant and overlapping; some is blatantly propagandist; and some, alas, is intellectually worthless. Dr. Emme does not always fulfill his editorial duty of critical comment or of textual analysis in showing the controversial circumstances in which certain statements were made to enable students to evaluate their worth. Secondly, it does not fully emerge from Dr. Emme's selection quite how controversial a subject air power has been. The impression given by this book is of a gradual revelation of the truth about air power. Nothing is quoted, for example, from the sections of the "United States Strategic Bomber Survey" critical of the achievements of Allied bombing forces during the war, and, among the documents bearing on the controversy over American defense policy, the statements of the protagonists of air power are given far greater prominence than those of their critics. It

is an unbalance which a more detached, editorial commentary would have done much to redress. Finally, many students of international politics will find highly controversial the uniformly unfavorable, editorial judgments of Russian intentions and policies over the last ten years. It is difficult, in the climate of the cold war, to escape emotional engagement; but in a scholarly edition of documents a certain degree of self-discipline in such matters is desirable. Nevertheless Dr. Emme gives us a wide selection of documents and comments on Soviet policy, and this is by no means the least valuable section of his book.

MICHAEL HOWARD

Lecturer in War Studies
University of London
Official Historian
Cabinet Office

- D. A. GRABER. *Crisis Diplomacy: A History of U. S. Intervention Policies and Practices*. Pp. xviii, 402. Washington, D. C.: Public Affairs Press in co-operation with the Center for the Study of American Foreign Policy, University of Chicago, 1959. \$6.75.

Breaking United States diplomatic history into four periods, 1789-1848, 1849-1898, 1899-1939, and 1940-1958, Miss Graber gives for each parallel accounts of actual interventions by the United States in other countries and of the principles professed by our government with respect to intervention. In the first period she finds the assertion of an unqualified principle of nonintervention designed to deter the Concert of European States from interventions in the Western Hemisphere. Actually the United States observed this principle only with limitations dictated by national interest. During the second period a doctrine forbidding intervention except as required for national security or permitted by treaty emerged, and the United States practice moved toward conformity with the principle. This trend was broken by the Spanish-American War and later interventions in the Caribbean area which continued into the 1930's. Since 1939 the United States first abandoned unilateral intervention in favor of collective

security, then finding the latter insufficient to meet the threats of cold war sought again grounds for intervention. It is Miss Graber's contention, fortified by hundreds of instances, that our policy has actually responded to immediate conceptions of national interest rather than to doctrinal positions or legal standards, and that in all four periods there was disparity between actual practice and professed principle.

These conclusions are unlikely to surprise students of United States diplomatic history. Much of Miss Graber's thesis and nearly all her evidence can be found in standard works of Samuel F. Bemis, Thomas A. Bailey, and others. Little new ground is broken in research; in some instances recent monographs upon particular points seem not to have been used. But the book is a useful survey which highlights our intervention practice. It can be commended especially to the general reader.

No definition of intervention is offered. Miss Graber indeed concludes that neat lines cannot be drawn between permissible and forbidden conduct. Therefore she treats as interventions conduct ranging from landing marines to withholding recognition of de facto governments or remonstrating against mistreatment of individuals or minorities. The reviewer continues to feel that it is preferable not to characterize the permissible ways of influencing the conduct of other states as interventions. It strains language to say, as Miss Graber does, that our postwar mutual defense treaties were made in order to provide justification for later interventions. Economic or military assistance which has been invited and is welcomed by the recipient state has not usually been thought an intervention.

C. H. McLAUGHLIN

Professor of Political Science
University of Minnesota

- LELAND M. GOODRICH. *The United Nations*. Pp. x, 419. New York: Thomas Y. Crowell Company, 1959. \$5.60.

WILLIAM A. SCOTT and STEPHEN B. WITHEY. *The United States and the United Nations: The Public View 1945-1955*. (National Studies on International

Organization.) Prepared for the Carnegie Endowment for International Peace under the auspices of the Survey Research Center, University of Michigan. Pp. xiii, 314. New York: Manhattan Publishing Company, 1958. \$3.00.

The second of these volumes is a report on the views of the American people regarding the United Nations during its first decade. Making use of research data derived from a large number of national attitude surveys and opinion polls, it outlines certain tentative conclusions about public sentiment on matters of international organization. Despite the authors' candid warning that the materials of various research organizations are often not comparable, the sheer accumulation of data in this volume is impressive and convincing.

Briefly, here are some of the conclusions reached by the authors, Scott and Withey: The United Nations was regarded by most people as an instrument to prevent war—and virtually nothing else. Knowledge about the organization was generally meager, even at times when it was dealing with a critical world situation such as the Korean conflict or the Berlin blockade. Its performance was most applauded during relatively peaceful or, from the American point of view, successful periods, while criticism was highest in times of frustration. Sentiment in favor of continued United States' membership in the United Nations was uniformly high. Most Americans even favored continuing membership if Communist China were admitted, although a great majority were themselves against admitting that nation. Groups that were better informed tended to support the United Nations more than poorly informed groups. Beyond this, there were virtually no significant differences in reaction among people living in various geographic areas nor among those of different political party affiliation. The greatest variations were related to education, with the higher educated groups likely to support the purposes and functions of the United Nations but also apt to be more critical of its performance. Most of this is fairly evident, but it is good to have some empirical evidence to reinforce common sense observations.

Professor Goodrich's volume is a textbook, although its Preface makes the usual obeisances to the general reader. As was to be expected from one of our leading authorities on the United Nations, this is a work of sound, informed judgment that will be of inestimable value in a variety of undergraduate courses. Unlike many surveys of the United Nations, Goodrich's study is not stifled by the details of structural organization. His chapters on structure and function are clear, succinct, and uncluttered by an underbrush of insignificant minutiae. At the same time, the author has placed his analysis firmly in the context of the international situation which has developed since the end of World War II. Recognizing the realities of national power and the significance of great power conflict, he does not, however, admit to despair in the light of the genuine achievements of the United Nations at a variety of levels. His assessment is calm and just; it leaves the reader with the feeling that not the least valuable asset of the United Nations is the group of clear-headed scholars like Goodrich who have made its study the center of their work.

HENRY R. WINKLER

Professor of History
Rutgers, The State University

JAMES W. WIGGINS and HELMUT SCHOECK (Eds.). *Foreign Aid Reexamined: A Critical Appraisal*. Pp. ix, 250. Washington, D. C.: Public Affairs Press, 1958. \$5.00.

The papers collected in this volume were prepared for a symposium on culture-contact in less developed countries held on the campus of Emory University. Their authors have re-examined United States foreign aid and in the majority of cases find it wanting or are neutral toward it. None give it wholehearted endorsement. Only H. G. Barnett takes a positive, constructive view of technical assistance in arguing for "aided self-help" in place of "imposition of assistance" and "progress by decree."

J. Fred Rippe asserts that "The assets of our people should not be wasted by overstaffing, extravagance in salaries, favoritism toward exporters, and sentimental

benevolence at the expense of coerced taxpayers. In comparison with traditional diplomacy at the height of its achievement, the programs are likely to be of minor significance in world politics. . . ." (p. 19).

Foreign aid is seen as ". . . a patchwork of conflicting ideologies, contradictory purposes, and confusing mechanisms" (p. 25) by Elgin Groseclose. "It represents an effort to identify Church and State, that is, to convert the government into an instrument of the moral conscience. It conforms to various ideologies, both Fascist and Communist, in that it represents an effort to identify the State with the totality of the social life. . . ." (p. 27). He feels that ". . . the federal government is not the proper instrument for the expression of the charitable and benevolent impulses of the citizens" (p. 41). Furthermore, "The United States is in fact doing concretely what Soviet Russia has been doing only through propaganda: it is pouring out vast sums to promote totalitarian and communistic economic and political systems" (p. 37).

George Peter Murdock assumes the role of a Cassandra to attack the "Truman-Eisenhower" philosophy of international relations as "fundamentally unsound," "inherently self-defeating," and "potentially dangerous" (p. 44). "Foreign aid, whatever its nature, has thus tragically injured the very ones whom it has sought to assist. . . ." "Experience and theory unite in demonstrating that foreign aid has not accomplished, and cannot accomplish, more than a minuscule proportion of what it aims to achieve" (p. 47). "The giver of foreign aid can never win. To expect to be appreciated or liked is incredibly naive. The only rewards to be realistically anticipated are envy and dislike, or, if the benefactions are generous enough, full-fledged hatred" (p. 51).

Helmut Schoeck thinks "people in the United States, hearts bursting with altruism, should not delude themselves by believing that they can really—through loans and grants from government to government—help the 400 million Indians. . . . Conceivably, the most promising thing that could happen to the long-range economic chances of the Asian masses would be for

their top planners to run out of Western Funds" (p. 98).

The perpetrators of foreign aid are identified by these authors to be, among others, religious leaders (pp. 1–2, 26), "liberals," many of whom exhibit a profound lack of confidence in the economic, social and political institutions of the United States. . . ." (p. 48), Barbara Ward (pp. 98–99), Gunnar Myrdal (pp. 102, 147–48), and intellectuals (p. 95). The intellectual seizes on foreign aid because he has an underdog he can champion. It helps him salve his own social conscience: he can ethically accept his own higher standard of living. He has always resented his insignificant role in the distribution of wealth. Now he has an almost unlimited field where he can manipulate billions and still have a good conscience while doing it.

Other authors present critiques of particular aspects of foreign aid without coming to summary judgments about its overall worth.

Contrary to certain statements in the book: Defense support has not been eliminated in appropriations for foreign aid (p. 31). Nasser's seizure of the Suez Canal had been planned before the United States denied him funds and was not simply a reaction to that denial (p. 51). It does not follow that "internationalism" has made "little or no progress" simply because the possibility of world war remains (p. 57). Much of the literature I have read on technical assistance does cite cultural values as important obstacles (p. 81).

The reader is left with the impression that the book might better be titled, "Foreign Aid Repudiated."

RICHARD W. GABLE

Associate Professor
University of Southern California

J. FRED RIPPY. *Globe and Hemisphere: Latin America's Place in the Postwar Foreign Relations of the United States*. Pp. xi, 276. Chicago: Henry Regnery Company in co-operation with Foundation for Foreign Affairs, 1958. \$6.00.

Neither the title nor the subtitle of this provocative volume is really explanatory of its contents. Professor Rippy admit-

tedly slights the political, diplomatic, and military aspects of Latin America's postwar international relations. He concentrates on a number of the economic problems, either neglected by most writers or obscured from public view in their intricate and sometimes devious courses.

The treatment is episodic: following three introductory chapters of primarily economic history the succeeding chapters deal with specific situations and reveal not only the fabric of the problems but also, and sometimes especially, the seams. Examples are his chapters on the "Inter-American Highway," "the canal zones"—Panama and Nicaragua, "rubber-planting fiascos," "fishery troubles," and so forth. Commentary is supplemented by many statistical tables.

The author writes with a good deal of moral indignation. He does not like the corruption and venality of various Latin American regimes; he takes a very dim view of the pressures, usually disguised, which were brought to achieve the consummation of many policies followed by the United States government. All is not "sugar 'n' spice" in United States-Latin American relations—much is sugar, of course, but to Rippy it has been demonstrably mixed with vinegar.

The author becomes the defender of that nebulous and often unsung individual, the American consumer and taxpayer. Many of the expenditures of the United States in and for Latin America were unwise, he insists, and cannot be continued except at the injury of the taxpayer; many grants, loans, and other aids have really been made, he maintains, because of the successful lobbying of automobile companies, manufacturers of road-building machinery, or those who stood to profit in other presumably unethical if not illegal ways.

Professor Rippy performs a service by directing attention to some of these overlooked economic problems and relationships. They have certainly been overshadowed by the space given in books and periodicals to the conventional political and strategic problems. His approach in much of his discussion may or may not be unduly choleric—that is a matter of subjective opinion, and certainly he cites enough evi-

dence to justify a good deal of indignation.

In the opinion of this reviewer the author, in his conscious omission of consideration of the political, fails to relate sufficiently strongly the economic problems he discusses—and the significance of them—to political attitudes, courses, and objectives. Few people will deny that communism is a threat in Latin America, though there is great disagreement as to the degree of the danger. The present volume would be still more useful if it dealt adequately with the relationship of such a matter, and other political problems, to the somewhat soured economic feast with which the author provides us.

The book could be worn as a hairshirt of sorts by various people in many countries of the hemisphere, and it is certainly stimulating and challenging to all who read it. Its controversial and forthright nature will necessarily, as the author confesses in his Preface, "expose it to the mercy of reviewers."

RUSSELL H. FITZGIBBON

Professor of Political Science
University of California
Los Angeles

JOHN D. MARTZ. *Central America: The Crisis and the Challenge*. Pp. ix, 356. Chapel Hill: University of North Carolina Press, 1959. \$7.50.

Persons concerned over the frequent reports regarding unrest in Central America will welcome this book. It presents a brief political history of recent events in each country, especially during the post-World War II period, and concludes with a frank criticism of the foreign policy of the United States in that area.

Mr. Martz spent two years studying and teaching in Central America. He was the recipient of a Buenos Aires Convention Fellowship, and has traveled widely in Latin America. He is also author of a work on Communist Infiltration in Guatemala.

The first chapter of the present work, called "Sub-Continent in Crisis," presents background material for the whole area which forms a sort of geographic bridge between the two halves of the Western Hemisphere. It is not a very pretty pic-

ture. Good agricultural land resources are fairly abundant but are concentrated in the hands of a very few people, while the masses of the population try to make a living on tiny plots, or work as laborers on the plantations. The large *latifundio* (estate) and the tiny *minifundio* (small plot) exist side by side. Tremendous contrasts exist between the few who enjoy wealth and the vast majority who live in poverty. Governments tend to be dictatorial in character. The democratically conceived constitutions usually contain clauses permitting the executive to declare emergencies at his pleasure and suspend guarantees of individual rights.

The author devotes a chapter to each of the six countries describing the major political events in each. Communist penetration in Guatemala is emphasized, and Communist influence in the other countries is discussed.

The final chapter, called "Challenge to the United States," deals with the foreign policy of the American government in this area. The author feels that United States diplomats have often been too intimate and friendly, on a first name basis, with Latin American dictators such as the late Anastasio Somoza of Nicaragua. He criticizes severely the various military assistance programs of the United States with the Latin American governments. He argues that "The instrumentality of the Organization of American States is such that United States military treaty assistance seems fatuous" (p. 328). He contends that the military in Latin America can be considered as a regressive influence. They tend to support the "strong man" and if they become dissatisfied with the state of affairs, they are likely to install a government of their own. Thus the chief executive will attempt to placate the military leaders with high salaries and numerous perquisites so that they, in turn, will encourage dictatorship. United States military assistance may be used, therefore, to delay democracy rather than to encourage it.

N. L. WHETTEN

Dean, The Graduate School
University of Connecticut

AMERICAN HISTORY AND GOVERNMENT

KARL LOEWENSTEIN. *Political Power and the Governmental Process*. Pp. ix, 442. Chicago: University of Chicago Press, 1957. \$6.00.

This admirable book originated in a series of lectures given on the Walgreen Foundation at the University of Chicago, a foundation peculiarly fruitful in evoking masterful, original contributions to American political thought. Among other Walgreen lectures of the past decade were the first versions of Kennan's *American Diplomacy 1900-1950* and Morgenthau's *In Defense of the National Interest*.

There is a certain family resemblance between the three works, for Loewenstein, like Morgenthau and Kennan, makes power the focus of his interest and considers politics in a narrow rather than a broad context. He thus runs counter to a considerable trend in recent writing on politics. Whereas much recent work in politics has called in the aid of the psychologists and the sociologists to broaden the context of political decision, and has sought to explain in terms of these other disciplines how political decisions are influenced or made, Loewenstein eschews all this. The pejorative way of describing his book would be to call it "old-fashioned"; but this would be sheer name calling, and entirely inappropriate to a book so original in thought, and so rigorous and scrupulous in method. One prefers to say that the book represents a refreshing change from much current writing. The vice of the school of political scientists who lean towards psychology and sociology is a certain flabbiness of thought, an inability to focus the problem precisely, which also infects their style. The power school, for some reason, almost invariably write better than their opponents. They may ignore some factors, but there is a geometric precision about their style, as about their arguments, that is an intellectual pleasure to peruse.

Loewenstein defends himself against possible criticisms by arguing that any attempt "to come to grips with the reality of the power phenomenon . . . by measur-

ing the degree and intensity of reciprocal interactions in the various sociopolitical configurations . . . has little chance of penetrating to the core of the power situation." He therefore confines himself to an examination of the central machinery of state power in various patterns of government: how, in each of them, political power is gained, how it is exercised, and how it is restrained. With a masterful and convincing display of the Germanic ability to subsume the bewildering variety of data offered by the real world into a framework of theory, he creates a "common conceptual roof" to explain the functioning of power under different régimes. The sections of the book deal with, first, the political process and the patterns of government; secondly, "horizontal controls" on power—control of the executive by legislature and judiciary, and so forth; thirdly, "vertical controls"—federalism, guarantees of individual liberties, and pluralism.

In working out his argument the author displays a precise knowledge of an astonishing range of political and constitutional data, drawing his examples at will from the experience of France, Germany, the United States, Japan, and British Commonwealth countries. In all instances the citations appeared to be both appropriate and correct. This book is a solid contribution to discussion of the central problem of government, the reconciliation of freedom with authority.

ARTHUR C. TURNER

University of California
Riverside

ARTHUR MAASS (Ed.). *Area and Power: A Theory of Local Government*. Pp. 224. Glencoe, Ill.: Free Press, 1959. \$5.00.

The concept of power is necessarily central to any concern with politics, and it is remarkable that the literature of the field has given so little attention to the division of governmental power on an areal basis. These papers do not quite reach the goal of the subtitle of the volume, *A Theory of Local Government*, but they do help to stimulate our thinking regarding the nature and implications of power and area.

The authors recognize that values influence the division of power, and their analysis is constructed around the use of government to secure liberty, equality, and welfare. It is not assumed, however, that this is a closed value system, and the question is raised whether the growth of security means a change in the areal dispersion of power. To attain values, power may be divided by process, function, and constituency; and the areal division may be either exclusive or there may be powers which are shared by several levels of government. This study also makes clear than any areal division, whether by constitutional provision or delegation, is dynamic both in form and intent. The movement of the American federal system with the political, economic, and social development of the country is a case in point familiar to most of us. Other virtues of this study are that it attempts to extend its analysis of the areal division of power to unitary as well as federal states, and although it is limited primarily to divisions of governmental powers, the authors recognize that they are necessarily related to the total power structure of society.

Paul Ylvisaker in an essay on "Some Criteria for a 'Proper' Areal Division of Governmental Powers" states in a provocative and concise manner the assumptions upon which this study is based and then advances a number of criteria as maxims. Unfortunately, these maxims cannot be fully developed in such a short paper, but they do raise some challenging questions. For example, a serious application of maxim one—"The assignment of powers to component areas should in each case be a general one, covering the whole range of governmental functions, rather than a partial one related only to particular functions"—would mean a radically different approach to the problems of local government. This reviewer wishes that the maxim that "The optimum number of levels among which to share the power to govern would seem to be three" had been developed more fully.

Our failure to develop a "general process of government" for metropolitan areas is becoming more and more embarrassing. Mr. Ylvisaker thinks we may be ready for

a general solution; but that if we must have a transitional stage in which one or more functions are chosen to be "the cornerstone of a more general system," a combination of planning and zoning might evoke sufficient citizen interest. Mr. Wood, however, would utilize transportation as the proper functional approach to a general process of metropolitan government.

There is a danger that any discussion of area and power will overemphasize efficiency and the necessity that the state be able to act. It is encouraging to report that this volume is interested in areas where debate is possible and political participation can be achieved. The political as well as the functional aspects of the problem are discussed by Mr. Robert C. Wood in his chapter on "A Division of Powers in Metropolitan Areas."

Area and power are also examined in chapters on the role of the states, the federalism of Canada, the writings of French political theorists, and the thinking of the Founding Fathers of the Constitution of the United States. These applications of the general theme perhaps attempt to cover too much ground, but they do provide us with valuable comparative insight into the problem.

This volume does not formulate a theory of local government, but it does give us a promising point of departure in developing one. It is encouraging to see this addition to a field of the literature of political science which has not received the attention it deserves.

LAWRENCE L. PELLETIER

President
Allegheny College

MARSHALL E. DIMOCK. *Administrative Vitality: The Conflict with Bureaucracy*. Pp. xiii, 298. New York: Harper & Brothers, 1959. \$5.00.

From long and wide experience as a perceptive student of government and of business in the United States and abroad, Professor Dimock, head of the Department of Government at New York University, examines the nature and values of orderliness in bureaucracy and of creativeness in enterprise. The best of each can be

blended, he concludes, through "administration by objectives" to contribute to institutional vitality. By this approach objectives are democratically defined and rules minimized to free officials and employees for the exercise of abilities, initiative, and ingenuity with attendant satisfaction and achievement in their work. The frequent conflict of precedents and rules with inventiveness and energy can be more nearly stabilized, through wise administration, to great social advantage.

A major asset of this stimulating, practical book is its analytical cataloging of the signs or evidences of institutional vitality or decay, of the basic concepts of sound bureaucracy and of potentially complementary enterprise, and of specific ways whereby an amalgam of the most successful organizational techniques can lead to energized administration. Pertinent, brief case histories of governmental and business growth and integrative leadership are interwoven with analysis. There is also critical examination of major theoretical approaches to the administrative process.

This book is a candid but ultimately optimistic appraisal of the admitted danger that attrition of effective leadership will stagnate complex and proliferating social institutions. "The best in bureaucracy is scientific management and technological progress; the worst is indifference to the consumer. The best in enterprise is innovation and energy; the worst is confusion." The best and the worst are scrutinized with meticulous insight meaningful to all who think of administration. Prescriptions for combining the best of enterprise and of bureaucracy, for "the blending of these two opposites," while inevitably and frankly suggestive of guidelines rather than of definitive detail, not only offer the wisdom of a leading practitioner and scholar in administration but also preserve the common touch of integrity, humility, and interest in people. In this urbane, readable exploration are many lessons from past and present for administrative progress.

FRANKLIN L. BURDETTE

Professor and Director
Bureau of Governmental Research
University of Maryland

JOSEPH M. BECKER. *Shared Government in Employment Security: A Study of Advisory Councils*. Pp. xiii, 501. New York: Columbia University Press, 1959. \$6.50.

Father Becker of Saint Louis University presents a detailed description of the workings of advisory councils for employment security agencies in fifteen states. His study shows the development of the council idea in employment security; its major use in the field of unemployment insurance rather than the employment service; the councils which have been most effective, moderately effective, and relatively ineffective. Although Father Becker recognizes that men might differ in the meaning of an "effective" council, he finds the most objective evidence of an "effective" council to be one which produces "agreed bills." The Wisconsin Council, which clearly is the author's model, has had four labor representatives, four employer representatives, and the state's director of unemployment insurance as its nonvoting chairman. The Wisconsin Council has not had public representatives. This Council from its inception in 1932 through 1959 has failed only once (1957) in reviewing the operation of the state's unemployment insurance law and agreeing on amendments. The resulting "agreed bills" have regularly received the support of industry and labor in the state legislature. The state legislature, with occasional minor changes, has almost as regularly amended the original unemployment insurance act in accord with the agreed bills. What makes the Wisconsin Council a success? The author's answer would include: the personal qualities and experience of the unemployment insurance director in the chairman's role; the inclusion of the leaders and decision-makers among employer and labor groups on the council; the absence of strong animosities among labor and employer groups together with a willingness to moderate differences; and a modest original unemployment insurance law which has been efficiently administered and gradually extended in coverage to benefit labor without excessive increases in costs to employers.

The author raises significant questions of

democratic theory and the political process. In effect he asserts that government, meaning generally the bureaucracy, needs to be watched. Political parties cannot do this as well as can representatives of the groups immediately concerned. Only labor and industry are interested in unemployment insurance. If the unemployment insurance program in its general operation and in its basic law meets the approval of or is supervised and framed by labor and industry leaders, then we have responsible democratic control. The role of parties is discounted, and to a degree deplored, although not ignored (for example, p. 204). These assertions on the value of advisory councils as a device for shared government would have gained if the author had given some attention to reasonably related studies which emphasize other aspects of the political process.

CLARA PENNIMAN

Associate Professor of Political
Science

University of Wisconsin

C. HERMAN PRITCHETT. *The Political Offender and the Warren Court*. (The Gaspar G. Bacon Lectures on the Constitution of the United States, Boston University.) Pp. 74. Boston: Boston University Press, 1958. \$3.00.

BENJAMIN FLETCHER WRIGHT. *Consensus and Continuity, 1776-1787*. (The Gaspar G. Bacon Lectures on the Constitution of the United States, Boston University.) Pp. 60. Boston: Boston University Press, 1958. \$3.00.

These modest little volumes preserve in print the Gaspar G. Bacon Lectures at Boston University for the academic years, 1956-57 and 1957-58. Both volumes examine important aspects of the Bacon Lectureship's permanent subject, "The Constitution of the United States," and both reveal this lecture series, which began in 1927, at its best, for both authors are concerned with two crucial questions: Why has the American constitutional experiment been so successful? How can the lessons of the past be most wisely utilized in coping with the unprecedented constitu-

tional and political problems which our nation faces today?

Mr. Wright, who was at the time he delivered his lectures President of Smith College, works at one end of the historical spectrum, the critical decade that separated the Declaration of Independence from the drafting of the Constitution at Philadelphia. Mr. Pritchett, who is Professor of Political Science at the University of Chicago, is concerned with a striking development at the other end of this spectrum, the important series of Supreme Court decisions between 1954 and 1957 by which a Court majority under Chief Justice Warren's leadership struck down certain of the more extreme efforts of the national and state governments to safeguard the nation's security against the threat of internal subversion.

President Wright's purpose is to show once more that the American revolutionary and constitutional period was marked by a strong consensus in the political and economic areas, and, where differences existed, by a very considerable willingness to compromise. In particular, it was an age that rejected the extremes of egalitarian and aristocratic theory and practice. Smith, Parrington, Hacker, and, above all, Beard, are vigorously criticized for their erroneous and once widely-accepted description of the 1780's as an era of black reaction. Fortunately, says Wright, later scholars have given us a sounder view of the purposes and achievements of the Founding Fathers so that we are now enabled to view them in their true light as neither reactionaries nor radicals, as men of experience and common sense, loyal to many established principles and institutions yet flexible and progressive in outlook, cognizant of the proper claims of property and other vested interests yet eager to discover new and better political forms. Above all, the age was marked by a strong continuity of beliefs, practices, and institutions. Past, present, and future were fused together in a tradition, albeit a changing one. As Wright sees it, this condition is essential to the success of any constitutional experiment. While only the main outlines of the story are suggested, and only favorable evidence is marshaled and that rather

sketchily, the thesis is developed with considerable interest and persuasion.

Professor Pritchett examines a series of eight or ten decisions of the Warren Court by which the excesses of Smith Act prosecutions, congressional investigations, and loyalty-security testing of government employees were declared illegal. One of the ablest contemporary students of constitutional law, Mr. Pritchett assembles his facts with great care and understanding. In his view the majority rulings in such cases as *Watkins*, *Sweezy*, *Slochower*, *Schwartz*, and *Yates* were both sensible and moderate. They helped establish a better balance between the interests of individual freedom and the needs of national security, and they reflected a proper, traditional exercise of judicial power. One wishes that critics of the Warren Court, including the eminent members of the American Bar Association, might read this short, accurate, skillfully written account of the work of the Court and ponder carefully its defense of the Court's findings. No recent volume supplies a better corrective to the lopsided and vehemently asserted views of these critics.

ROBERT K. CARR

Professor of Government
Dartmouth College

JULIUS PAUL. *The Legal Realism of Jerome N. Frank: A Study of Fact-Skepticism and the Judicial Process*. Pp. xxii, 177. The Hague: Martinus Nijhoff, 1959. Guilders 17.90.

This is a good and useful, little book even though in my opinion the author fails to achieve his announced goals. Dr. Paul states his purpose: "to systematically and critically assess the ideas . . . of the late Judge Jerome Frank, . . . a leading exponent of the so-called school of American 'legal realism.'" The study is sound and carries evidence of thorough preparation, but is limited in scope and penetration.

The author says: "I have read all of Jerome Frank's published writings on law and politics, and as much criticism of his work as I could find." This statement cannot be challenged. Yet too much of the

author's thesis is based on Judge Frank's early full-length book, *Law and the Modern Mind*. Dr. Paul's implied justification that much of Frank's subsequent writing is elaboration and modification of his original theories or replies to critics and detractors hardly excuses the relatively little direct attention accorded Frank's judicial opinions and other numerous publications.

The critical appraisal promised by the author fails to materialize in terms of a fresh or personal appraisal, largely because of the method used. Dr. Paul, in preparing his study, selected some half dozen topics characteristic of Frank's contributions to the philosophy of American law, presented these briefly in appropriate philosophical, social, and legal settings, and for purposes of evaluation marshaled an array of concurring and opposing views selected from the publications of recognized scholars. The study is more than a study of the literature, however. The Paul personality is not entirely lost. On occasion his conclusions and convictions are positively stated, yet over all the reader is required to make his own judgments and, for the most part, to discover the author's convictions from his selection of assembled evidence rather than from stated conclusions.

It appears, too, that the author has fallen short of his goal to "present a systematic statement of Frank's philosophy of law and its role in modern society." He has selected and subjected to appraisal several samplings from Judge Frank's ideas. The five pertinent chapter headings are: "The crusade against the 'myth' of legal certainty," "Psychology as the new weapon of attack," "The role of the judge in the judicial process," "Trial by jury and the problem of legal education," and "Frank's contributions to the philosophy of American legal realism." Perhaps it would not be unfair to say that Judge Frank is the pivotal point about which a dissertation on a segment of legal history has been written. The study demonstrates breadth and thoroughness of study. It implies a knowledge of and appreciation for Judge Frank and the "legal leftists" far broader in scope and more penetrating than is revealed from the printed page. It is hoped that Dr.

Paul will continue the studies, presumably initiated here.

HAROLD M. DORR

Professor of Political Science
University of Michigan

DAVID J. SAPOSS. *Communism in American Unions*. Pp. xii, 279. New York: McGraw-Hill Book Company, 1959. \$7.50.

Few authors are as well qualified as David Saposs to discuss communist activities in the American labor movement. In this book he brings up to date the work started many years ago in his *Left Wing Unionism*.

After a brief introductory statement on the communist inheritance from early radicalism, Saposs devotes the two major sections of the book to communist penetration of the American Federation of Labor (A.F. of L.) and of the Congress of Industrial Organizations (C.I.O.), respectively. This is followed by a discussion of the role of union leaders, rank and file unionists, employers, and government in combating communist domination. A final chapter summarizes recent developments, including efforts of some of the remaining communist-led union groups to find sanctuary as affiliates of more respectable unions. The scholarship is sound and the documentation careful and complete.

More questionable is the allocation of space between the two former rival federations. Despite the major importance of the communist issue within the C.I.O. and its relative insignificance in the A.F. of L., Saposs has chosen to devote equal space to the two groups. This he does by telling at great length the story of communist efforts to dominate Hollywood unionism. Though he explains that he followed this course because of the abundance of data available, the result is to distort somewhat the picture of communist penetration of the two federations.

To a degree the C.I.O. section goes over the same ground that Max Kampelman covered in his fairly recent *The Communist Party vs. the C.I.O.*, although there is enough difference in focus and treatment to make the Saposs book a welcome addition.

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Comment.....R. V. Greenslade and P. A. Wallace
Reply.....G. W. Nutter

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Saposs is critical of many union leaders, as well as of some employers and government officials, for failing to combat communist influence with sufficient vigor. Perhaps his sharpest criticism is of the national leaders of the C.I.O., prior to the expulsion movement of 1949-50; had they given leadership to the anticommunist groups, he asserts, rather than followed a policy of conciliation and compromise, the communist strength might have been reduced much earlier. Yet Saposs finds the same blindness to communist dangers, for the sake of temporary advantage, in the recent willingness of some unions to admit communist-led groups without adequate screening.

The author is also critical of some management groups for supporting communist unions rather than their rivals in representation battles, because of a hope for more advantageous contract terms from a hard pressed leadership; and he has little sympathy for government administrative officials who, interpreting their powers narrowly, failed to act as vigorously against communist unionists as they might have.

Anticommunism may be pushed so hard, however, that other equally important objectives are sacrificed. The ranks of anti-communists in labor have included racketeers and autocrats, who do not thereby deserve support. Civil rights and freedom of choice may be trampled, and honest, militant unionism endangered, as government seeks to root out communist unionism. It seems to this reviewer that in his anticommunism Saposs risks losing sight of these other values.

Readers will find in the volume a wealth of data on communist tactics in unions. They are unlikely thereafter to view communist unionism with complacency.

JOEL SEIDMAN

Professor of Social Sciences
University of Chicago

RICHARD H. ROVERE. *Senator Joe McCarthy*. Pp. 280. New York: Harcourt, Brace and Company, 1959. \$3.95.

De mortuis nihil nisi bonum!

So said the ancients. Not so, however, said Richard Rovere when writing about the late Senator from Wisconsin. His

book *Senator Joe McCarthy* is an interesting and readable work.

Rovere leaves no one in doubt as to what he thinks of the late Senator McCarthy.

"A man of loose tongue, intemperate, trusting to tumult, leading the populace to mischief with empty words." These are not Rovere's words though they might have been. These were written centuries before by Euripides in his description of the typical demagogue.

Rovere's marshaling of the facts, his discussion of details in connection with various incidents cited in support of his conclusions indicate his close and intense study in trying to learn what made McCarthy act the way he did.

He sees no good in the man. Early in his book he states ". . . the social and economic order didn't interest him in the slightest."

It is hard to believe that a person with enough determination to do a complete high school course in a single year, who worked his way to a college degree, who aspired to public office, and won several times by the vote of the people ending up in the high office of United States Senator could be as wholly depraved as Rovere would have us believe.

One can hardly quarrel with the mass of evidence that Rovere presents as to McCarthy's complete immersion in the cause of anticommunism and the ruthlessness with which he pursued his course.

Rovere suggests that McCarthy deliberately selected communism as the expedient issue in politics. Many have thought that his taking up the fight on communism was almost completely accidental since the speech given by him in Wheeling, West Virginia, had been prepared for another speaker. Whether true or not, many have felt that the unexpected response from the Wheeling audience caused him to repeat the speech, that this set off the wave of deep anticommunist reaction, and that McCarthy simply decided to ride the wave.

Rovere brings out the fact that at no time did McCarthy try to set up a separate organization, start another political party, or take advantage of what might have been an opportunity to aim for political dicta-

torship. In fact, as Rovere brings out, McCarthy was almost as critical of the Republican party as he was of the Democrats, of Eisenhower as he was of Truman, and of Dulles and his foreign policy as he was of Acheson.

Rovere injects much of his feelings throughout the book. However, he has given a graphic description of a short period in the history of this country when one man following a single issue was able to occupy the stage almost by himself and to play to a tremendous audience.

JOHN SPARKMAN

United State Senator from Alabama

HENRY SAVAGE, JR. *Seeds of Time: The Background of Southern Thinking*. Pp. viii, 312. New York: Henry Holt and Company, 1959. \$4.50.

Possibly the best criticism this reviewer can pass on this book is to say that she is glad that it was sent her for review, as otherwise she might not have encountered it.

In process of developing his theme the author presents the reader with a recapitulation of the history of the South, and a remarkably adequate one, considering that the whole tale is condensed into about three hundred pages. Always he seeks out in each period the factors which contribute to the composite product which he thinks of as the southern mind. It must suffice here to note two characteristics: an intense sectional pride born of the rich contribution to the national government, and bitterness from the Reconstruction period. Until Lincoln southern men had filled the presidency fifty of the seventy-two years; John Marshall, a Virginian, presided over the Supreme Court for many years and through a series of great decisions solidified the foundation of central government; this section had contributed a striking number of members of the cabinets and diplomatic service. Under the impact of numerous disasters, southerners turned to the past for solace. From the long slavery controversy and jealousy of New England prosperity, attributed to the protective tariff, came resentment, and from the loathed measures of reconstruction came even hatred.

Possibly the most valuable chapter is the concluding chapter, devoted to a discussion of the desegregation issue, which—be it remembered was written by a Southerner—is the fairest discussion of this difficult question which this reviewer has seen. It would be well if every American could read it. It stresses the necessity for the South to abandon its intransigent attitude toward the Supreme Court's decision for acceptance of integration. He sees only folly in closing schools when most of southern problems arise from insufficient education. Self-appointed demagogues have bred a fear which real leaders have not dared to combat. This has bred deterioration in race relations in all classes and an organized, aggressive Negro electorate in the South, prompted by the National Association for the Advancement of Colored People (N.A.A.C.P.). He pleads for time—a generation at least—to make the adjustment: to release the potentially great southern moderation; time for youth under liberalizing influences to grow up, for education to operate, for Negro migration to reduce the Negro majorities in certain sections and to raise the economic and social standards of the Negro; time for voluntary abandonment of traditions deeply ingrained for a quarter-millennium.

ELLA LONN

Professor of History, Emeritus
Goucher College

SOPHIE HUTCHINSON DRINKER. *Hannah Penn and the Proprietorship of Pennsylvania*. Pp. iv, 207. Philadelphia: National Society of the Colonial Dames of America in the Commonwealth of Pennsylvania, 1958. \$4.50.

This scholarly little volume is composed of letters from the correspondence of Hannah Callowhill Penn, the second wife of the founder, in her successive roles as "A Person Unexceptional"; "Helpmeet" (1701-1718); and "Sole Executrix" (1718-1726); and informing and scholarly comments, modestly called "explanatory notes," lists of documents, and fine, pertinent illustrations. In a brief Foreword on the provenance of the correspondence, Mrs. Drinker tells the story of the discovery of the larger group of letters at Stenton, the

home of James Logan, where Deborah Norris Logan found and copied them, adding notes of her own. Transferred to the Historical Society of Pennsylvania, they were later augmented by another collection found in England when the Penn estate was finally settled.

Of the 115 letters in Hannah Penn's hand, fifty-eight appear in the volume. Practically all are addressed to men high in the business and government of the province, much the largest number to James Logan. Occasionally replies and individual letters available only in photostat are used. Spelling and punctuation are modernized, but the "Salutations and Farewells" are given as they were written, in order to retain as much as possible "the flavor of early 18th century style." A special feature of this volume is the historical background with frequent suggestions by the editor on the letters as they follow in chronological sequence. Contrary to the usual practice of printing material of this kind in different type, it appears in the same format as the letters.

Seen from the point of view of her correspondence, Hannah Penn appears in a new perspective, not only as a remarkable administrator of the proprietary government of the province, but also as a much neglected, but heroic character in the annals of America's pioneering women. Conspicuous in the historic background of her remarkable career are feudal institutions of the past in process of disintegration under the pressure of concepts of a new economic and political order. Amid these, her dynamic energy and ability, buttressed by early practical experience in the not inconsiderable business of her father, and later as "Helpmeet" to her invalid husband in the management of the affairs of Pennsylvania, enabled her to step into the position of an absolute proprietor assuming "rights and accepting a responsibility greater than possible for a woman of our own day, and greater even than any customary for one of her contemporaries" (p. 6). For fourteen years, until her death in December 1726, she battled for her rights and the province. Aably advised by James Logan and others but guided largely by her own judgment, she had the satisfaction of seeing her ef-

forts crowned with success. Penn's will was confirmed; the claims of her stepson, William III, set aside; the mortgage paid off and the long negotiations for "the Surrender" ended; Governor Keith finally dismissed; and the province left to her sons. These and many other problems of the proprietary called for the exercise of statesmanship of the highest order, and it is in the negotiations on these as they appear in the correspondence that Mrs. Drinker discovers the real nature of Hannah Callowhill Penn.

The text is well documented. There is a detailed Bibliography, a list of documents of Hannah Penn, a good Index, and on the flyleaf a map in gray of Bristol, England, suggestive of the Quaker atmosphere of the book. New and scholarly in its approach to a partially familiar story, the volume merits a place in every library concerned with colonial history. Some readers may object to the criticism of historians for their inadequate treatment of "the Surrender." Others will wish to probe further into the provenance of Hannah Penn's correspondence and the relations to Penn papers in general. Meanwhile, the timely appearance of this interesting and original appraisal of the only woman governor in the annals of the commonwealth again suggests the publication of a comprehensive edition of Penn papers in line with the current trend in American historiography of publishing the papers of its great men.

WILLIAM E. LINGELBACH

Professor of History, Emeritus
University of Pennsylvania
Librarian, Emeritus
American Philosophical Society

EUROPEAN HISTORY

EUGENE DAVIDSON. *The Death and Life of Germany: An Account of the American Occupation*. Pp. ix, 422, xx. New York: Alfred A. Knopf, 1959. \$5.75.

The whole story of the occupation of Germany has not yet been written, and since it involves an analysis of such enormous and complicated problems, it may never be written. In recent years a num-

ber of researchers have contributed greatly toward a more complete understanding of what has transpired in the German area since the war. Among these, Balfour, Litchfield, Golay, Hiscocks, and Zink come readily to mind. In the present book, the author, although he gives the subtitle *An Account of the American Occupation*, actually deals with the international planning for the occupation as well as with many aspects of the total occupation including all of the four zones. In fact Germany in the years from 1945 to 1955 is much more the focus of attention than the American occupation, even though American actions and behavior clearly constitute one of the author's principal concerns. Only a very careful reading discloses the book's main contribution—the presentation of a very thorough and judicious assortment of revealing data on every aspect of the occupation.

Some critics might complain that the presentation is diffuse and not particularly original. But the thorough and careful research which the author has done in this vast field deserves nothing but commendation. After all, when a great nation in a vast industrial area is completely dissolved in ruins, it is only by patching together the results of all the postwar labor and thought that one is enabled to approximate an over-all judgment of what has happened. Certainly the author deserves to be applauded for delving so deeply and circumspectly into the vast documentation, some of which still remains untouched.

It is good to be reminded of the shortcomings of Allied planning about Germany, and what has been done year by year until West Germany regained her sovereignty in 1955. One easily forgets the seamy side and often overlooks the most constructive side of Allied, and especially American, occupation. Here the whole panorama, year by year, is carefully reviewed and cautiously evaluated. No book yet written has covered so much so well.

Some phases, it is true, are not clearly brought into focus. For instance, the development and growth of German self-government, at first in the American zone and later in the British and French zones, together with the identification and support

of its leaders, is inadequately presented. Sentences here and there and election returns from time to time are mentioned. But the net result or its significance is lacking. Likewise the frequent references to America's great proconsul, General Clay, are too often related to his punitive moments and not to his generous, helpful, and statesmanlike actions without which the whole occupation would have been a colossal failure.

A brief concluding chapter displays the author's hopeful opinion of West Germany's future. "The democracy of West Germany is young," he writes, "but it is successful—enormously successful from the economic point of view, less so from the political." He feels that both Germany and the American occupiers learned much. How true! His final words deserve quotation: "In the survivors and in the millions who became aware of what the Nazis had done the voice of the child [Anne Frank] re-echoes. Not everyone hears it directly and some remain deaf to what they hear. But it is there for all of them, for the people of good and ill will, for the confident entrepreneurs of business and government, for the workers and housewives, the Bavarians, the Rhinelanders, the Prussians in exile. It can never be silent."

JAMES K. POLLOCK

Professor and Chairman
Department of Political Science
University of Michigan

JOHN L. SNELL. *War-time Origins of the East-West Dilemma over Germany*. Pp. 268. New Orleans: Hauser Press, 1959. \$7.00.

John L. Snell, Associate Professor of History at Tulane University, tries to retrace the slippery, and often highly dangerous, road of Allied wartime policy with regard to postwar Germany. From the first foreign ministers' meeting of the "Big Three" in 1943 to the summit conferences of Yalta, Teheran, Potsdam, and to the continuous negotiations on lower levels, it led to the present-day division of Germany—which, as of today, unhappily appears as the end of the road.

By skillfully using abundant official documents, personal memoirs and biog-

raphies, studies published by American, British, and West German authors, and also the yet unpublished *Potsdam Papers* of the United States Department of State, Dr. Snell has succeeded in presenting an interesting account of the Western intrigues, illusions, and idealistic intentions which permitted the Soviets to arrive at their goal of a semipermanent division of Germany. The American domestic struggle between advocates of a "soft" and a "tough" policy toward postwar Germany—the latter strengthening the Soviet hand, though unwittingly more often than not—and the American desire to win the war first, and worry about the postwar world later, are Dr. Snell's main themes. His compilation of dispersed source material results in a rather comprehensive chronicle.

However, the emerging picture remains regrettably one-sided since the author's account of Western diplomacy and policy is, perhaps unavoidably, considerably better documented and more perspicacious than his account of Russian diplomacy and policy. Unfortunately, the author seems to disregard the very fact that Russian policy concerning postwar Germany was planned and executed by Communists, and therefore represented an important campaign in their long-term struggle for world conquest. Dr. Snell indicates that Soviet policy toward Germany was mainly motivated by the two German invasions which Russia experienced in this century, while other and weightier rationales and goals are not mentioned. His concluding remark that hostility against Germany "lives on among the peoples of Eastern Germany, obstructing compromises on the contemporary German problem," seems unduly naive. Surely it was not the feelings of, say, Polish or Czech citizens which instigated the Berlin crisis or which led the Soviet rulers to break their pledge of permitting free elections in East Germany; there is little evidence to the claim that "the peoples of Eastern Europe" today show greater hostility toward Germany than toward their Soviet oppressors. Without evidence, Dr. Snell submits that "the degree of support for Germany among Soviet citizens has been exaggerated in the American press since 1945." Yet the American press has

shown extremely little interest in this question, while the high degree of support for the Germans has been established by Alexander Dallin, Eugene Lyons, and George Fischer.

Although Dr. Snell's treatment of Soviet policy—which, after all, has been and is the key factor in the contemporary *East-West Dilemma over Germany*, the subject of this book—does little to promote our understanding, his chronicle of American wartime planning for postwar Germany supplies a useful and meritorious starting point for further, more critical researches.

NORBERT MUHLEN

New York City

AUGUST VON KNIEREM. *The Nuremberg Trials*. Translated by Elizabeth D. Schmitt. Pp. xxii, 561. Chicago, Ill.: Henry Regnery Company, 1959. \$12.50.

Of all that has been written on the Nuremberg trials this is by far the most comprehensive and learned inquiry into the legal problems involved. Mainly concerned with the twelve trials following the proceedings against Goering and the others, the author, who as chief counsel of I. G. Farben, was himself a defendant, shows, with devastating logic and citations from the trial records, how one-sided the proceedings were, and on what dubious moral and legal grounds many of the defendants were convicted.

The trials were conducted under hybrid law which was neither continental, Anglo-American, nor international, and as a result safeguards that had grown into the established systems of Europe, England, and America were often lacking. The prosecution had overwhelming advantages in preparing and conducting their cases. Legal counsel was available to the defense only after the prosecution lawyers had had months to gather their evidence and to interrogate the accused; the witnesses and key documents were in their control, and the defense could examine the documents and many of its witnesses only through the courtesy and co-operation of the occupying power which was also the judge and prosecutor. Eighty defense lawyers, in 1947, had one telephone among them, with

no opportunity of making calls outside Germany, or bringing witnesses from abroad or travelling there themselves.

The Tribunals although called international were entirely American after the first trial. Among them were good and true judges, but others were manifestly incompetent and biased, and it is no wonder that their decisions conflicted. In the Krupp judgment, the court quoted twenty-five pages from the prosecution's final plea, and left out a crucial "the," which made it appear that officials of the firm had asked for forced labor, whereas the letter in evidence showed they had wanted higher food rations for the 300 laborers assigned them. In the High Command case, the court held that a defendant had done nothing to soften the harsh orders he had drafted, when in fact the very document cited included mitigating phrases the accused had inserted. This part of the document, however, was omitted.

Like other able lawyers the author sometimes tries to prove too much. The treatment of Russian prisoners of war was scarcely a reprisal as he asserts. Hitler's exhortations to disregard international law in this struggle between two irreconcilable ideologies preceeded the start of the campaign. The case Mr. Knieriem presents is too sound to benefit from such technical improvements.

EUGENE DAVIDSON

Bad Tolz, Germany

E. STRAUSS. *Common Sense about the Common Market: Germany and Britain in Post-War Europe*. Pp. 168. New York: Rinehart and Company, 1959. \$3.50.

The title of this book might better be "Uncommon Sense about the Common Market." It accepts few of the enthusiastic expectations found in most American presentations of this important European development. It even questions the justifications usually advanced by American writers: that the enlarged geographic market will be an enlarged economic market; and that the political integration towards which it strives is to be desired.

The author's point of view is British and is strongly colored by his belief that the

Community as it stands is bound to be dominated by Germany.

In brief his argument runs as follows: The European Economic Community in conjunction with the Coal and Steel Community and Euratom is an extremely important development. Britain neglects it at her peril. Its founders have shown great skill in overcoming many difficult problems but they have been unwise in failing to recognize that in any customs union the strongest state will dominate. Hence, unless new forces are introduced Western Germany is bound to control the Community. A major element of weakness in this domination is the open border with East Germany. West Germany would undoubtedly surrender the Community if this could be done in return for a united Germany.

Great Britain's attempt to protect her own position in relation to the Customs Union was to propose the device of the industrial Free Trade Area. The other members of the Organization for European Economic Co-operation (OEEC) found a common interest with her. However, the six did not regard access to the market of the Free Trade Area as a sufficient inducement.

From the standpoint of British industry and commerce the continental market has been and can be important. But if the Community were to depart from its present policies and adopt protective tariffs, then British industry would be at a severe disadvantage. Furthermore, the continental countries will have a favored position in the overseas associated territories such as French Africa and the Belgian Congo.

The author sees two important, possible additional offers which the British might have advanced which would have been more attractive than the Free Trade Area. The first of these is to have opened the Commonwealth Preferential Area to the Community. The second is to make available to Euratom its fund of nuclear technology.

However, it is when such proposals as these are made that one begins to realize the cultural width of the English Channel and the inherent difficulties if the United Kingdom is to become part of the "European" body politic.

There are a number of the author's judgments concerning the Community with which one is inclined to disagree. He underestimates the economic strength of France and the Benelux countries. While paying formal deference to Monnet as the "true founding father" of the Community, he minimizes French leadership and emphasizes German. He also underrates the extent of Dutch and Belgian leadership in the origination, promotion, and development of the Community as well as the other postwar organizations in Europe.

However, the book is written to encourage the search for means whereby the United Kingdom may associate itself in effective leadership with continental countries. As such it deserves wide and thoughtful consideration.

THOMAS C. BLAISDELL, JR.

Professor of Political Science
University of California
Berkeley

NATHAN LEITES. *On the Game of Politics in France*. (A RAND Corporation Research Study.) Pp. xiii, 190. Stanford, Calif.: Stanford University Press (first published in French, 1958), 1959. \$4.50.

Dr. Nathan Leites' new work is an inquiry into the nature and causes of the *immobilisme* of governments of the Fourth Republic—their lack of decision, dispersion of responsibility, and postponement of action until it is determined by *force majeure*. Most commentators have been content to ascribe these defects to the multiplicity of parties in French politics, which itself derives from the number and extent of political divisions within the country. Mr. Leites suggests that however important such doctrinal differences have been in the past, their significance under the Fourth Republic has come to be exaggerated. He therefore directs our attention to the codes and customs governing the behavior of politicians and statesmen, to the unwritten "rules of the game," and especially to that institutional introspection which gave more importance to maneuverings in the Assembly than to the domestic or international events from which they derived.

Every institution in fact creates its own

rules and *mœurs*, and thereby imposes some degree of unity on its members. This is as true of a Rotary Club as it was of the French National Assembly. In political institutions indeed it is an indispensable part of the process by which conflicts of ideology and interest in the community are translated into political opposition. Yet this purpose can only be served effectively if government remains genuinely representational, and if political opposition itself leads to some decisive reconciliation or compromise of interests.

It is just this which the Fourth Republic failed to achieve. In an excellent Introduction to the book Professor Brogan asks how far the game of politics in its French form is duplicated in other countries; but this is one of the many questions which Mr. Leites deliberately excludes from more than cursory consideration. We are left to wonder why French politicians are so lacking in that ambition for power and responsibility which characterizes their counterparts elsewhere. On the other hand the work scarcely indicates any of the achievements of the regime, except in an Epilogue, provoked by the events of May 1958, in which the author hastens to the defense of "republican legality."

For this reason, the book will have greatest value for the specialist rather than the general reader. It can perform an invaluable service in dismissing or revising preconceived notions, and illuminating aspects of French politics not usually evident to the outsider; but it is most likely to do so for the reader who is able to place it in perspective, and who is aware of the questions which it provokes.

WILFRID F. KNAPP

St. Catherine's Society
Oxford

JAMES JOLL (Ed.). *The Decline of the Third Republic*. (St. Anthony's Papers, No. 5.). Pp. 127. New York: Frederick A. Praeger, 1959. \$3.50.

This little volume consists of a collection of four papers—three by British scholars and one by an American scholar—dealing with phases of the disintegration of the Third French Republic during its final six years.

The first paper, by Max Beloff, interprets the riots of "The Sixth of February" of 1934 in terms of whether they should be considered an abortive coup d'état, and if so, why it failed. The author's conclusion is that, although there was some linkage with the future "men of Vichy," the evidence now available does not prove the thesis that the riots were an attack on the Republic itself.

In the second paper, entitled "The Making of the Popular Front," James Joll skillfully reconstructs the events leading to the short-lived electoral alliance of French Communists, Socialists, and Radicals during the mid-1930's. The Popular Front, observes Mr. Joll, was built outside parliament as a countermove to rightist demonstrations—almost entirely by Communist initiative, and, as it turned out, largely for their own ends. The dilemma of the Socialists and the hesitations of the Radicals over joining such a combination for "united action against war and fascism" are vividly portrayed. Once in power, following its smashing electoral victory of 1936, the Popular Front, due to Communist sabotage, could hold together only long enough for Leon Blum to launch an economic and social "New Deal" for France; but it was too late to implement this "social revolution" before tragedy struck from without.

In the third paper, on "The Rhineland Crisis of 1936," W. F. Knapp attaches special importance to the French army's lack of preparedness to move effectively against Hitler—even if the British had been willing to support such a policy on the part of the Quai d'Orsay. But the disease of appeasement had spread too widely in both countries, while France was already showing signs of the national demoralization that was to culminate in the debacle of 1940.

The subject of the fourth paper, by John Sherwood of Columbia University, is "The Tiger's Cub: The Last Years of George Mandel." Here we follow the political vicissitudes of one of the few "strong" leaders left in the Third Republic—a man who conceivably might have become a second Clemenceau, his early mentor, if he had not been so sensitive to

rightist attacks on his Jewish identity. Mandel, with Paul Reynaud—and at a different level De Gaulle—formed the only "solid core of resistance" to the German invaders; but even they were overwhelmed by the tide of defeatism that swept over France as its supposedly "invincible" army collapsed before the Nazi *blitz*.

These four studies, all of them examples of careful, historical scholarship, convey in their ensemble a graphic but depressing picture of the forces of division and intrigue that undermined French morale and shattered French patriotism during the last days of the republican regime which, despite its institutional weaknesses, had contributed much to the modernization of French life over two generations. Its immediate successor, alas, was destined to play a less enviable and more ephemeral role on the French political stage.

WALTER R. SHARP

Professor of Political Science
Yale University

RICHARD BARRON. *Parties and Politics in Modern France*. Pp. xi, 213. Washington, D. C.: Public Affairs Press, 1959. \$4.50.

A principal problem within French political life during the period from 1945 to 1958, or "from DeGaulle to DeGaulle," was to hold together enough support in the center to put down those groups on the left and on the right that wanted traditional party activity to cease. In the 1947 municipal elections, for instance, only 25 per cent of the vote favored the continuance of party life within the parliamentary regime. And this quarter of the voting electorate was a conglomerate of factions that found many points of disagreement.

In the face of this puny center were the strong and well-disciplined Communists on the left and the conservative, Catholic Movement Republicain Populaire on the right. DeGaulle, who had the nation as a whole at heart, wanted to do away with partisanship, and so he organized his own party, or rally, to end all parties. Many people sincerely believed in 1947 that the success of DeGaulle would mean the end of the Republic and of democracy.

The central interest of the book is the contest—the life struggle—between the internally divided center, mainly the Socialist party, on the one hand, and the two giant movements that sought to kill while supporting or to support while killing the regime of the Third and Fourth Republics on the other hand. As usual, it was the external political equation that conditioned domestic party orientation, for until German influence was eradicated, DeGaulle could count even Communists among his followers; whereas after 1946 it was the Communist danger that rallied men to the DeGaulle standard. The author has set for himself the task of straightening out the alignment of parties and groups since 1945 and of giving the reasons for the many changes.

He attacks his subject by giving us an interesting chapter on French political motivations and traditions. He then studies the three principal parties separately, the Communist, the Socialist, and the Movement Republicain Populaire. The lesser, and sometimes the more familiar parties, are grouped in a final chapter.

The author is scholarly and objective. If he leans at all, it is toward the hope for a continuance of free party life within the framework of parliamentary government. The Third Republic seems to him to have met many of the political and psychological needs of France. He fears that the great monolithic parties will destroy democratic government, although the one on the right may not be as destructive as the one on the left. His style is clear and his Notes, which are at the end of the volume, are detailed and voluminous.

Dr. Barron does not recount election details in great number, but rather is interested in party structure, in electoral systems, in recruitment and education of members, in party discipline, in finance and in changing party platforms. He includes a good analysis of the history of DeGaulle's political life down to the autumn of 1958 when he returned in order to try his hand at settling the Algerian trouble. DeGaulle feels the pulse of the nation as does no other man, says Dr. Barron.

The book is timely, and it makes a valu-

able contribution to our literature on political and party life in contemporary France.

W. HENRY COOKE

Visiting Professor of History
Harvey Mudd College

M. K. DZIEWANOWSKI. *The Communist Party of Poland: An Outline of History*. (Russian Research Center Studies, No. 32.) Pp. xvi, 369. Cambridge, Mass.: Harvard University Press, 1959. \$7.50.

This volume fills a gap in English literature on the origins and past performance of communist parties in the world. Founded in December 1918, the Communist party of Poland is one of the oldest. Due to the prominent role played by some members of the pro-bolshevik socialist organizations in Poland in the 1903-1917 bolshevik movement, in the October revolution, and during the first decade of Soviet Russia, the "Polish bolsheviks"—Dzierżyński, Kon, Radek, Unszlicht, Pestkowski, Marchlewski—held a special position in the Russian and international communist movement. Although the author does not dwell on this subject, his volume contains many interesting leads for the study of this little-known topic.

It is only natural that in presenting the history of a political party, the author had to project it against the background of current political, economic, military, and other developments in Poland. The author, however, could not resist the temptation to go sometimes too far in presenting background developments. This brought into the volume fragments of interesting accounts on Polish-Soviet relations, on the Polish-Soviet war of 1919-1920, and on the operations of the communist-dominated Polish state. But these fragments are not necessarily needed for the presentation of the subject, and sometimes blur the continuity of the history of the party.

Professor Dzierzanowski collected and presented the most important facts and events which led to the founding of the party and its activities before and after World War II. The documentation, obtained from scarce Polish sources, is rich and lucid. The last five weeks before the founding congress, December 16-18, 1918,

when the SDKPL and PPS-Lewica acted jointly under the leadership of an Inter-party Council, deserved perhaps broader treatment. For the student of international communism the volume will be a welcome reference work. The scholar searching for details of developments and texts of documents will find adequate source references.

In presenting background information on the events in Poland in 1919-1921, the author tries to formulate new concepts which are not always relevant. So, for instance, speaking about the Polish-Soviet war of 1919-20, he calls it in February 1919 a "small war" (p. 82) and in April 1920 a "full scale armed conflict" (p. 87). It was, in fact, the same war which in January 1919, at a time when there was no contact yet between the Polish and Soviet forces, started with the order to Soviet forces to advance in the direction of the Vistula and Warsaw (*Grazhdanskaia voina*, Moscow 1930, vol. III, pp. 151-153). There were three phases of one war, but not different wars.

W. S. SWORAKOWSKI

Assistant Director
The Hoover Institution
Stanford University

MILOVAN DJILAS. *Anatomy of a Moral: The Political Essays of Milovan Djilas*. Edited by Abraham Rothberg. Pp. xxxii, 35-181. New York: Frederick A. Praeger, 1959. \$2.95.

This series of eighteen essays contains a strong indictment of Tito's regime by a man who at the time of writing was one of the top-ranking members of the party and government hierarchy of Yugoslavia. These essays also express a thorough disappointment and disillusionment of a man who had dedicated his life to the party, convinced that the Communist revolution would bring about a better, more humane, and more creative life for all. Djilas finally came to the bitter realization of the fact that it was not idealist-humanists, but power-seekers, careerists, and opportunists who took over the control of the party and of the government after the seizure of power by the Partisan fighters, after much destruction and suffering, and after several hundreds of thousands of human lives were

coldly sacrificed to achieve this objective. And instead of a system of democratic socialism in which everything was to be done to improve the well being of each human being and in which every member of the new society was to have a say in the affairs of his community and of his country, the profiteers of the revolution have developed a system of arbitrariness, chicanery, and inhumanity. An exclusive and exalted caste composed of self-centered, grabbing, and beastly individuals has imposed its rule over the rest of society. Their own selfish interests as well as the interest of the caste as a whole have become paramount. To their internal intrigues and bickering for power everything else is sacrificed. There cannot be progress in such a society, Djilas concludes, only regression, demoralization, and disintegration. The only possible salvation from the sad fate of the Revolution, according to the author, is a return to the old pre-Revolution philosophy of idealism, humanism, dedication, and self-sacrifice. Therefore the Communist party, as a monolithic, dogmatic, omniscient, and all-powerful organization, is outdated and should be disbanded. Power should be in the hands of the masses. A group of intellectual leaders should dedicate their lives to educating the masses in the principles and practices of a democratic socialism—communism. Only if such developments take place is there hope that the fruits of the Revolution will not be abused and lost.

Such a course of events would entail the loss of power by those who are at present in control of the party and of the government. By disbanding the party they would lose the main instrument of their power. The reaction was therefore quick and determined against this challenge and threat to a caste which had just begun to enjoy its newly-acquired, worldly possessions and privileges, its luxurious city homes and its country villas, its servants and governesses, its exclusive boxes in the theatres and stadiums, its special food and clothing stores, its shiny cars with government-paid chauffeurs, as well as its exclusive social life, and its love affairs. In a hastily convened meeting of the Central Committee of the party, presided over by

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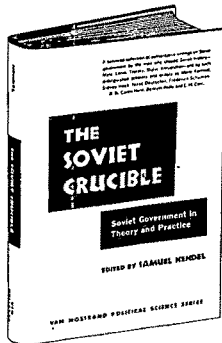
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Notice of

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In accordance with the Bylaws of the Academy, the Annual Business Meeting of the members will be held on Monday, February 8, 1960, at 2:00 P.M., at the offices of the Academy, 3937 Chestnut Street, Philadelphia, Pa.

The Annual Report of the Board of Directors will be presented, directors elected, and other important business transacted.

James C. Charlesworth
President

Tito, charges were brought against Djilas by Edvard Kardelj, the party's ideologist, who accused him of "revisionism," the greatest sin in this system of monolithic dogmatism conceived and built by Lenin and Stalin. Thus Kardelj used the same arguments against Djilas as Lenin did against his own opponents in the early days of his party, as if nothing had happened since. Of course the whole "trial" was window-dressing. There could be no fair debate of principles, as Djilas had hoped for. There were only accusation and condemnation in the inquisitorial, Soviet-style, tradition. The ruling caste was protecting its vested interests and therefore condemned Djilas as the enemy of the party, divested him of his party and government positions. Djilas was eventually sentenced to long years in prison, since the new caste, still insecure in its power, feared the man who knew them so well. But the spirit of this Montenegrin fighter has not been broken. He has continued to fight for his ideas and against the new masters, as his well-known work, *The New Class*, written in prison, testifies.

The work under review is very significant, not just as a personal document of another disappointed Communist, but much more as a work written by a leading Communist while he was still at the summit of party and government power in a Communist-ruled country. This work is particularly significant also because the author points out the injustices and inhumanities of the Communist system even when some external features of its police regime are relaxed for the sake of appearances and in order to appease democratic and humanistically minded public opinion in the West.

D. A. TOMASIC

Professor of Sociology
Indiana University

JOHN A. ARMSTRONG. *The Soviet Bureaucratic Elite: A Case Study of the Ukrainian Apparatus*. Pp. 174. New York: Frederick A. Praeger, 1959. \$6.00.

There are several reasons, according to the author, why the Ukrainian elite provides a particularly valuable case study for an understanding of contemporary So-

viet leadership: since almost all of the higher officials in this area were replaced during the 1938 purges, the process of tracing the current elite can begin with that year; because few middle level officials have been transferred to and from other regions, the apparatus in the Ukraine can be studied as a distinct and relatively homogeneous group; source materials on the subject—newspapers, books, memoirs, Soviet dissertations, and the like—are numerous; and, finally, Khrushchev, who rose through the Ukrainian party hierarchy himself, has used the apparatus there as a basis for extending his own power, transferring an unusual number of Ukrainian officials into the top Soviet leadership.

In the careful, step-by-step development of his analysis, the author identifies the bosses of the Ukrainian apparatus, examines in detail their training for leadership, considers their various responsibilities at different levels of the hierarchy, and isolates their mechanisms for control—and also the mechanisms by which they themselves are controlled.

Perhaps the most striking impression which emerges from an examination of the Ukrainian apparatus, according to the author, is the human diversity within the outwardly monolithic structure. This diversity does not necessarily signify weakness, but the author does tend to support the impressions of many recent visitors to the Soviet Union to the effect that the "new oligarchy" provides considerable opportunity for mobility and change.

To date the dominant leadership group is still composed largely of "men of '38," trained prewar; but the pressures upon them are great, and the incidence of heart trouble high. As a group they may not last many years longer.

These leaders, almost to a man, rose from the ranks through practical political ability and cunning. Few of them were formally educated. By contrast, the men who will succeed them—almost wholly trained after the war—will be university and technical school graduates with very different views of the world and of the society in which they live. There may be a growing tendency for a leadership of this kind to combine with industrial manage-

ment in a number of technocratic groups formed on a regional or economic basis, and yet, despite this trend, "the present oligarchy," the author feels, "is a long way from being a technocracy." In any case, the dominance of the Ukrainian-apparatus elite means a strengthening of oligarchic—as contrasted to the Stalinist autocratic—control of the Soviet Union. What will happen to the oligarchy as more and more of the younger members of the elite move into positions of influence remains largely to be seen.

ROBERT C. NORTH

Associate Professor of Political
Science
Stanford University

RICHARD HARE. *Portraits of Russian Personalities Between Reform and Revolution*. Pp. viii, 360. New York: Oxford University Press, 1959. \$6.75.

In his previous book, *Pioneers of Russian Social Thought*, published in 1951, the author describes the struggle after the Napoleonic wars of the Russian intelligentsia against a sterile bureaucracy and for a discriminating europeanization of their country. In his present book he extends his research from the end of the Crimean War to the October Revolution of 1917. Against the background of the changing political scene he draws the portraits of fifteen personalities who, mostly doubting the benefits of westernization, searched in their different ways for an alternative course. The author thereby takes fresh evidence into account.

The portraits are those of Nikitenko, a plebian conservative of the reform period who represented the "hardy, honest, and energetic section of the rising middle class which formed the principal moral backbone of post-reform Russia" (p. 3), Bakunin, the aristocratic anarchist, the man of "spontaneous duplicity," the "bewildering blend of sincerity and fraud" (p. 41), Turgenev, the "good and generous liberal" (p. 96) who "caught and recorded in flight the rapidly changing pattern of Russian society" (p. 69), Dostoyevsky, "who could not justly be named either a revolutionary socialist or a republican, but at most an

impassioned political dreamer and diligent free thinker" (p. 112), Tolstoy, the social and religious rebel who demolished "the whole misleading radical fixation on discernible laws of history and social change" (p. 193), three representative Narodniks, three religious-minded intellectuals, three thinking statesmen, and finally Kropotkin, the respectable, benevolent anarchist.

Most, if not all of them, justify their presence in this gallery, and the presentation by the author is excellent. His judgment is authoritative, and the treatment is impartial. It is not the author's fault if some of the pictures seem faded and remote in period, environment, and national characteristics, but an assessment by the author of the influence of these analysts and prophets, reformers and revolutionaries on the political parties of their time and the course of events would have helped the reader in his appreciation of their lifework.

The author has wisely left "suggestive analogies with present-day experience to the reader's own imagination" (p. vi). It was the anarchist Bakunin who stated in his *Confessions* over a hundred years ago: "Communism has spread, and continues to spread, as much from the top as from the bottom. In the masses it lives as a vague desire, an instinct to rise higher—in the higher classes as an indefinite and helpless fear, the result of weakness and an impure conscience. That fear and the unceasing outcry against communism have nearly done more to promote its advance than communist propaganda itself" (p. 36). "True," wrote Nicholas I, for whom the *Confessions* were written, in the margin.

OTTO HEILBRUNN

Gerrards Cross
Bucks, England

ALFRED ERICH SENN. *The Emergence of Modern Lithuania*. Pp. 272. New York: Columbia University Press, 1959. \$6.00.

This is essentially a study of the political and diplomatic efforts of the leaders of the Lithuanian national movement to establish an independent Lithuanian state.

The bulk of the book deals with the period from September 1917 to May 1920 during which, to use the author's words,

"the Lithuanian national state evolved from a council of twenty-two men with no definite authority into a regularly constituted and elected government" (p. 221).

In addition there is an introductory chapter on "The Development of Lithuanian Nationalism" and a concluding chapter which summarizes the author's views on the factors responsible for the emergence of independent Lithuania.

The book is based on a great deal of conscientious research, but, in the opinion of this reviewer, has several serious shortcomings.

In the first place, in his effort to concentrate on the activities of that handful of dedicated people who identified themselves with the cause of independent Lithuania, the author seems to have divorced himself to a considerable degree from the geographical and social reality in which these men have acted. The presence of other national groups in the territories claimed by the Lithuanians is barely mentioned and their political aspirations are largely ignored.

The book contains no information on the number and distribution of the Lithuanian population either before or after World War I. Such information, even if based on somewhat inaccurate figures of the pre-war Russian censuses, would have provided the reader with some facts necessary for the evaluation of fantastic territorial claims advanced by the Lithuanian nationalists.

The same may be said about the author's treatment of the social organization of the Lithuanians themselves. He provides virtually no information about their occupational or educational structure, nor even about their political groupings and orientation. One looks in vain for a discussion of the origin and development of Lithuanian political parties which are mentioned occasionally or for an evaluation of their relative strength and influence among the people.

Finally, despite his praiseworthy effort to be objective, the author, perhaps under the influence of his main sources, occasionally steps out of his role of an impartial observer to assume one of a defender of Lithuanian nationalism. For example, he reiterates again and again that the policy

pursued by the Lithuanian leaders was the only one possible under the circumstances, without ever trying to prove why any other policy was, as he puts it, "out of the question."

He maintains this even with respect to the Lithuanian intransigence about Wilno, although in this case the "impossibility" of a different approach was clearly psychological, not political. The author seems to be conscious of this himself when he points out that "had the Poles not stopped the Bolshevik advance, Lithuania might well have fallen under Soviet control in spite of the peace treaty" and that "Vilna would have served as an entering wedge for the Bolsheviks to conquer Lithuania" (p. 220).

In spite of these limitations, the book is an informative and useful survey of the emergence of Lithuania as a modern political entity. Its value is augmented by a chronological table, lists of members of consecutive Lithuanian governments, and an extensive Bibliography.

KONSTANTIN SYMMONS

Professor and Chairman
Department of Sociology and
Anthropology
Wilkes College

TITUS KOMARNICKI. *Rebirth of the Polish Republic: A Study in the Diplomatic History of Europe, 1914-1920*. Pp. xiii, 776. London and Toronto: William Heinemann, 1957. 3/3s.

Shortly before the end of World War I an independent Poland had been promised by the Allies; a Polish army had been equipped by France; and a provisional government set up in Paris. But there had been no independent Polish state since the eighteenth century, and to create one *de novo* presented well-nigh insoluble problems.

What were the boundaries of Poland to be? Were they to be drawn on historical, ethnological, strategic, or economic lines? Should Wilson's principle of self-determination be applied, and how? Unfortunately Poland never had any natural boundaries. To draw new ones on the west, north, and south involved annexations of lands hitherto belonging to the German and the

Austro-Hungarian empires; to draw them on the east was still more difficult, since the rise of Bolshevism thrust Russia into civil war.

At the peace conference at Paris the French and British could not see eye to eye in regard to the future of Poland. Traditionally, France had ever been pro-Polish, and France wanted a strong and powerful Poland as an ally against Germany, but Britain was opposed to weakening Germany too far. The weaker Germany became all the better from the French viewpoint, and France advocated ceding Danzig outright to Poland, giving that country a wide sweep through the valley of the Vistula, Posen, Galicia, and a return to the Polish boundaries of 1772. Quite different, however, was the British tradition. It had been one that favored a balance of power between a few big states. If Germany lost too much power by the peace treaty, and France allied with Poland gained too much, that balance of power would be lost.

The result was a compromise. Poland was not given Danzig but merely economic rights; there were plebiscites ordered to check her gains in the west and south. And the peace conference ended with no boundary on the east whatsoever, since what was taking place in Russia in 1919 was anybody's guess.

Meanwhile England and France continued to differ in regard to Poland. Both countries opposed Soviet expansion; but Lloyd George proposed to fight Bolshevism in the region of the Baltic whereas Clemenceau urged that the French-trained Polish army act as the spearhead of the counter-attack of the West.

Pilsudski, chief of state at Warsaw and commander of the Polish army, led his troops deep into the heart of the Ukraine, capturing Kiev in May, 1920. Immediately a Red counterattack drove him back to the gates of Warsaw. By the treaty of Riga in 1921 the eastern boundary of Poland was finally drawn, well to the east of the German trenches in Russian Poland in 1915-1916.

WALTER P. HALL

Professor of History, Emeritus
Princeton University

LUIS DIEZ DEL CORRAL. *The Rape of Europe*. Translated by H. V. Livermore. Pp. 310. New York: The Macmillan Company, 1959. \$5.75.

This book, translated from the Spanish, is written in essay style. Its chapter titles are: I, Europe and Universal History; II, Decadence or Dispossession; III, Europe Seen from Spain; IV, The Oecumenical Scene and Theme; V, The Expropriation of the Rural City; VI, Secularization and Historical Dynamism; VII, Alienation in Art; VIII, Nation, Nationalism, and Supernation; and IX, Europe, the Sorcerer's Apprentice.

As the chapter titles suggest the book is a philosophical rather than historical treatise, seeking to establish general conclusions concerning European history and its institutions, the relations of Europe to the outside world, and of one period of European thought and life to another. The reader is frequently confronted with abstract observations which arouse philosophic speculation, but not always clarity of understanding. Nuggets of valuable truth and frequently quotations are intermixed with less valuable theorizing.

As the title, *The Rape of Europe*, indicates, the author has a theory to advance to which he devotes considerable attention especially in the second chapter. His idea appears to be that Europe through its expansion spent much of its vitality—true in the case of certain countries—and its culture was expropriated by peoples outside Europe. He fails to say just how or in what respects although he does mention the rise of Japan with institutions modeled on those of Europe to rivalry with that continent. He refers to the opinions of historians for the causes of the decline of Rome and Greece and states that authors living between the two world wars of the twentieth century discoursed on the possibility of European decline.

The author is so engrossed in his conception of Europe's loss of vitality to the rest of the world that he completely ignores the important contributions made by the overseas world since the beginning of the modern period to European science and culture, to social life, to promoting the power of European governments and to

expanding greatly European commerce and wealth.

The author draws on his wide knowledge of European scholars in the field of civilization to furnish many valuable interpretations of European historical institutions and developments. His is a scholar's book requiring painstaking checking on sometimes obscure illusions to gain the full richness of his meaning.

Throughout the book are many thought-provoking statements. As an example, the author mentions that England regarded as the originator of the Industrial Revolution had for some time previously been assisted by technicians from other nations such as Italian shipbuilders, German miners, and Dutch hydraulic engineers. Besides, technical advance was made possible partly by appropriating other civilizations' inventions, among them the compass and printing type from the Far East. Great thinkers such as Roger Bacon, Leonardo da Vinci and Francis Bacon centuries before the technical age had suggested many of the inventions which later took place. Thus, Paul Mantoux, quoted by the author, called the Industrial Revolution "the sudden bursting and flowering of seeds that have lain dormant for many years."

It was Europe's development of modern science and technology which made its civilization dominant over that of other continents.

JAMES E. GILLESPIE

Professor of History, Emeritus
Pennsylvania State University

DANTE L. GERMINO. *The Italian Fascist Party in Power: A Study in Totalitarian Rule*. Pp. x, 181. Minneapolis: University of Minnesota Press, 1959. \$4.50.

Professor Germino has given us an excellent book on a most interesting theme. He has analyzed the structure and the functions of the National Fascist party of Italy through its operations and political vicissitudes. The National Fascist party was indeed a new tool for despotism, and the author describes its origins, its formation, its structure, its paramount quality of expediency—"the flexible structure"—its compositions, its leadership, its function

in taking over Italian youth and then the school system. He also analyzes the internecine struggles of the party—which echo the same story in Berlin or in the Kremlin—and in a most interesting chapter the uneasy *modus vivendi* between party and police, party (in particular, the fascist militia) and Royal Army and party and bureaucracy.

The book has a thesis which it demonstrates in a most effective and convincing manner: Fascism was a totalitarian regime, of the Nazi and Soviet variety. Even though a number of illustrious writers, among whom the author quotes Hanna Arends, state that fascism did not have totalitarian traits, Germino shows well their shortcomings and presents fascism in a true and systematic perspective.

The book is written on the basis of firsthand documents and Germino has left no stone unturned nor available document unread. The book has also the quality of being extremely readable. This reviewer undertook the reading of it with a sense of duty, and ended it with a feeling of pleasure. Its Bibliography is of the most complete and the Notes, conscientious and unpretentious.

To indulge in "nit-picking": On page 115 one reads "... in September 1923 the Government ... sent three legions of Militia to Corfu" where they remained until May 1924." As far as I know, no militia was sent to Corfu during the brief Italian occupation which started at the end of August 1923 and ended in September of the same year. But the author should not worry about this slip. He has written a worthy book.

RENZO SERENO

Professor of Political Theory and
Cultural Relations
School of Advanced International
Studies
Johns Hopkins University

J. A. LAUWERYS (Ed.). *Scandinavian Democracy: Development of Democratic Thought and Institutions in Denmark, Norway and Sweden*. Pp. 437. Copenhagen: The Danish Institute, The Norwegian Office of Cultural Relations, and The Swedish Institute in co-operation

with the American-Scandinavian Foundation, 1958. \$6.00.

RAYMOND E. LINDGREN. *Norway-Sweden: Union, Disunion, and Scandinavian Integration*. (A Publication of The Center for Research on World Political Institutions, Princeton University.) Pp. ix, 298. Princeton, N. J.: Princeton University Press, 1959. \$5.00.

In recent years a number of books and pamphlets have appeared dealing with present-day conditions in the Scandinavian countries, many of them sponsored by the publishers of *Scandinavian Democracy*. While these earlier publications discussed specific aspects of Scandinavian life, the present volume aims "at explaining and discussing the ideological and philosophical foundations of the economic, social, political and cultural institutions of the Northern lands" It is a composite work of twenty-three Scandinavian specialists who contribute articles under the following headings: What Is Democracy?; The Heritage of History; Justice, Security, and Government; Economic Life in Scandinavia; Building Up Democratic Attitudes; The Defense of Democracy; Scandinavian Democracy and the World. While this volume is free of the easy generalizations and fulsome praise that characterized many of the American books about Scandinavian countries published between the wars, it is nevertheless plain that the authors have faith in the system they describe. They definitely feel that the Scandinavian "way of life" is worthy of the attention it has attracted and that the small countries have a role to play not only in cultural matters but also in international affairs. To American readers the sections on economic life and on the building of democratic attitudes will probably be the most interesting. These chapters discuss various aspects of Scandinavia's controlled capitalism—"the middle way"—and the formative influence of education, the arts, and the mass media on the democratic tradition. In view of the important part which literature and religion have played in the life of the Scandinavian peoples, it is disappointing that these factors are given so little emphasis. Nevertheless, this book is undoubtedly

the best introduction to present-day Scandinavia available in English.

While *Scandinavian Democracy* has one chapter dealing with current co-operation between the northern countries, *Norway-Sweden* deals with the specific relations between these two countries from 1814 to the present. From 1814 to 1905 Norway and Sweden were joined in a dynastic union characterized by almost continual friction. On two occasions war between them seemed a definite possibility. In this case "political amalgamation" did not produce a "security-community," to use the terminology of The Center for Research on World Political Institutions which has sponsored this volume. Only when the union was dissolved did the relationship evolve in such a manner that war has become unthinkable.

The purpose of this study is to analyze the causes of the friction before 1905 and the later development of strong bonds of understanding. Professor Lindgren's research makes it clear that the union, which in some respects stamped Norway as an inferior partner, was the source of numerous irritations that were blown to dangerous proportions by the intense nationalism and the fierce political battles of the period. The union thus became a barrier to that very amalgamation it was presumably designed to further. With its dissolution forces were freed which, building on close affinities in language, religion, ethnography, and traditions, reared a vital "security-community" which included also the other northern countries.

The author has studied carefully all the principal Scandinavian authorities dealing with the union problems. The main part of the book, covering the hectic period from 1902 to 1908, is built on exhaustive examination of the primary sources, many of them unpublished.

There are a few points with which this reviewer takes issue. Statements on pages 26, 60, 61 make it appear that the Norwegian constitution gave the king absolute veto over legislation. The constitution granted the king merely a suspensive veto over ordinary legislation but said nothing about the veto in connection with consti-

tutional amendments. It was over this latter point that fierce political battles raged prior to the introduction of the parliamentary system in 1884. On page 57 the great poet and national leader, Bjørnstjerne Bjørnson, is made to appear even more of a weathercock than Ibsen accused him of being. His attitude toward politics, religion, and the union question mellowed with time but did not undergo any radical change. On page 256 it is correctly stated that the Danes "complained much less than the Norwegians" over Swedish yielding to German pressure during the early part of the Second World War, but it must also be said that the Danes had much less cause for complaint. Little matters like these, however, do not detract from the value of this interesting, thorough, and well-written book. It should attract the attention of people concerned about international affairs because it deals with the central problem of our time—that of "integration" or understanding between nations.

CLARENCE A. CLAUSEN

Professor of History
St. Olaf College

AMRY VANDENBOSCH. *Dutch Foreign Policy since 1815: A Study in Small Power Politics*. Pp. x, 318. The Hague: Martinus Nijhoff, 1959. Guilders 25.50.

In his Preface the author expresses his gratitude to various institutions and persons to whose aid he admits himself indebted, amongst others to a number of persons in the Ministry of Foreign Affairs, chiefly in the archives division. "That their help," he adds, "was not more extensive was not due to unwillingness on their part to be of service." What then was it due to? The author politely evades an answer to that question, but we can guess in the light of a sensational utterance by the president of the foreign press association in Holland. He published early in March of this year an outspoken criticism of the official information service, which is so skimpy that several foreign correspondents have left The Hague and settled in Brussels, where they are treated with less formality and polite reserve. It is an old

complaint. The Foreign Office staff at The Hague has always considered the country's foreign policy a special preserve from which they barred inquisitive outsiders. During the First World War several protests from members of parliament induced the then minister to be more communicative, but the policy of secrecy, though attenuated, is evidently still in force. Hence it is not easy for a scholar from abroad to inform himself thoroughly of the policy of the Foreign Office.

Dr. Vandenbosch has done his research with industry and skill and has succeeded, despite official aloofness, in producing an informative and solid piece of work. The Second World War had a revolutionary effect on the conduct of Dutch foreign affairs. It brought to an end the nineteenth-century system, maintained for a hundred years with great caution and success, of neutrality and independent action. It was abandoned for a policy of participation in various movements towards West-European union: the Benelux Plan, the North Atlantic Defense Pact, the Coal and Steel Community, the European Common Market. In the seventeenth century the Dutch Republic was one of the Great Powers. No one in Holland would wish to see their country regain that position of influence. But through the judicial opinions of her leading statesmen Holland is still able to have a voice, and often a persuasive one, in the councils of Europe.

An extensive, yet strangely incomplete, Bibliography concludes the volume. Among important publications that it ignores is C. Van Vollenhoven's brilliant monograph, "The Three Stages of International Law," and his justly famous doctoral thesis accessible to English-speaking readers in *Bibliotheca Visseriana* (Vol. X), which presented such novel ideas that it was not fully appreciated at the time of its first appearance in print, but which, as Jhr. W. J. M. Van Eysinga asserted in 1933, the year of Van Vollenhoven's death, "seems self-evident truth to the present generation."

ADRIAAN J. BARNOUW

Professor Emeritus
Columbia University

NORMAN ST. JOHN-STEVAS. *Walter Bagehot: A Study of His Life and Thought together with a Selection of His Political Writings*. Pp. xvi, 485. Bloomington: Indiana University Press, 1959. \$7.50.

While Bagehot's political essays are not readily available in convenient form, both his great work on *The English Constitution* and his *Physics and Politics* are. Likewise, while no recent biography is available, Alastair Buchan's long-promised full-scale biography, probably to be definitive for our time, is due from the press at any moment. Hence, one may seriously question the value of the present work, which contains in its Introduction a brief biography, a not uninteresting and curiosity-provoking analysis of Bagehot's religious views, a nice but too brief analysis of him as a writer and literary critic, and a somewhat less illuminating statement of his position as an economist, a moderate-sized commentary on his political ideas, followed by a very considerable analysis, not so much of his work on the English Constitution as of what has happened since. This analytical and descriptive section occupies half of the total Introduction and, largely independent of much of what has preceded it, is also in considerable part rather loosely related to Bagehot, save that it is organized by themes according to the structure of his own work.

The selections may prove interesting, may be sufficient to give the reader an over-all impression of the range of Bagehot's thought on government and on politics, and of the way in which he analyzed statesmen, though the omission of essays dealing with this country is a little unfortunate. Perhaps the *English Constitution* cannot readily be cut, but, because of its availability, its reproduction here, taking up about half of the space devoted to the writings, is less than warranted. While, on the other hand, the very brief abstract from *Physics and Politics* scarcely gives the unfamiliar reader an adequate feeling or understanding of that work. Also Mr. St. John-Stevas in his Introduction devotes less attention to this work than its due.

This book may be valuable to a student or general reader who wants to know

something about Bagehot and to get a firsthand taste of his political writings. It does not contribute notably to scholarship, and, for those who already know or are interested in Bagehot, the price of the convenient assemblage of a few essays is rather high.

THOMAS I. COOK

Department of Political Science
Johns Hopkins University

PETER GAY. *Voltaire's Politics: The Poet as Realist*. Pp. xii, 417. Princeton, N. J.: Princeton University Press, 1959. \$6.00.

Great men are often controversial men. Sometimes they bring controversy on themselves, through their own ambiguities and complexities. Sometimes later scholarship is responsible, as it dissects, distorts, and misunderstands. In the case of Voltaire, responsibility seems to be equally shared. At any rate, we are left with a "Voltaire problem," notably in the area of Voltaire's political action and thought.

Mr. Gay contends that Voltaire scholars have slighted this aspect of his work, and have never successfully placed Voltaire's political ideas in the framework of his time. He notes the curious contrast between the variety of views about Voltaire, on the one hand, and the general acceptance of a rigid stereotype on the other. Mr. Gay is no disciple, but he believes that the sage of Ferney has been much maligned. He was, Mr. Gay tells us, a realist in politics; a practical hard-headed man of empiricist temper and relativist views; a reformer more concerned with conditions than with theories; a crusader for the right of free expression and the rule of law. Mr. Gay rejects the thesis that Voltaire advocated something called enlightened despotism, for despotism of any kind violated his deepest convictions. What Voltaire favored instead was "constitutional absolutism," an illogical yet attractive doctrine derived from the old *thèse royale* used by the king's lawyers for centuries. Mr. Gay admits, however, that Voltaire's doctrine provided no institutions, save the force of enlightened public opinion, that would guard against the corruption of absolutism into despotism.

In the course of his argument, Mr. Gay touches lightly upon or digs deeply into a great many intriguing aspects of the eighteenth century. There are provocative accounts of Voltaire's relationships with Frederick and Catherine; of Genevan politics; of the long guerrilla warfare between king and parliaments; of the Calas affair and the whole matter of judicial procedures in a prereform age; of Voltaire's campaign against *l'infâme* which, Mr. Gay argues, meant neither fanaticism nor religion in general, but Christianity in all its forms. There is also a defense of the Enlightenment temper that is refreshing in our age of despair.

Mr. Gay has already given us a most comprehensive study of Eduard Bernstein; his work on Voltaire is of equal importance as a reassessment of the man and the age. He writes with vigor, verve, and understanding on a subject that requires all of these qualities. Special note should be made of the thorough and useful Bibliographical Essay, and of the handsome format that continues to make Princeton the envy of all university presses.

GORDON WRIGHT

Professor of History
Stanford University

ARNOLD BRECHT. *Political Theory: The Foundations of Twentieth-Century Political Thought*. Pp. xviii, 603. Princeton, N. J.: Princeton University Press, 1959. \$12.00.

Professor Brecht is to be congratulated for having crowned his long and distinguished career in government both as a practitioner and a scholar with a work of the first magnitude. The prediction can be made without any hesitation whatsoever that this book will henceforth be studied by every serious student of political theory, whether or not he agrees with the author's findings and conclusions. Two reasons are behind this prediction: first, it is the only book in any language that surveys, in minute and scholarly detail, the many and varied methodological and scientific efforts to construct valid foundations for a theory of politics, law, sociology, or ethics. Some of the English or American authors discussed by Professor Brecht are relatively

well known in the United States; but he also examines many Continental European thinkers, whose works have not been translated into English, opening up new vistas and theories which so far have been terra incognita even to the well-informed American scholar. There is hardly a single strand of thought missing in the fabric woven so skillfully by Professor Brecht. Written in a lively and clear style, his book is a veritable encyclopedia of twentieth-century political theory, an indispensable starting point for any further study and research.

The intellectual situation in which Professor Brecht has created his great work can briefly be stated as follows: the decline of religious faith has largely resulted in the abandonment of the belief in the eternal verities in political, legal, and social philosophy. The loss of excessive certitude as provided by traditional metaphysics and religion has led, particularly in the last half century, to the opposite extreme of excessive despair, as reflected in the various manifestations of relativism. What Professor Brecht is trying to do in his *Political Theory* is to explore the possibilities which are still left to creative reason in the formulation of general philosophical principles in politics. He calls his own position "scientific value relativism." He does not claim to provide an ultimate solution for the problem of the relationships of science and values, but seeks to discover in what ways science can be useful in analyzing and formulating universally valid criteria of values. Whereas religion and metaphysics solve this problem too easily by making critical reasoning unnecessary, and relativism claims that reason is futile in this area, Professor Brecht tries to build a middle ground of enlarging the function of reason and science in the world of values. Even if one concedes that ultimate values cannot be proved scientifically or by critical reasoning, there is still a wide area of creative rational exploration before one gets to the ultimate values. Much of the tension, confusion, and strife in human relations occurs with respect to values which are not ultimate, but intermediate, and here reason has not even begun to fulfill its potential.

The above brief summary gives a very inadequate impression of the scope and depth of Professor Brecht's work, both as a masterful summary of the existing scholarly literature on the subject and as a pioneering effort of moving forward, of breaking the intellectual deadlock created by the decline of religion and the rise of relativism.

WILLIAM EBENSTEIN

Professor of Politics
Princeton University

G. R. ELTON (Ed.). *The New Cambridge Modern History*, Vol. II: *The Reformation, 1520-1559*. Pp. xvi, 685. New York: Cambridge University Press, 1958. \$7.50.

This second and most welcomed volume of the *New Cambridge Modern History* describes and analyzes the forty years that began with the accession of Charles V as Emperor and the excommunication of Luther and closed with the signing of the treaty of Cateau-Cambrésis, the accession of Elizabeth to the throne in England and the recrudescence of Catholic power in a church not only ready to stand her ground but ready to take determined action against her foes. When compared with the second volume of the first *Cambridge Modern History*, the scope of the newer work is chronologically more restricted, but the results of new planning are effective.

The second volume of the new history contains twenty chapters written by specialists. Even a hasty glance at the Table of Contents shows the work to be the result of international co-operation and in no sense exclusively the reflection of Cambridge or even merely of British thought. In the chapter on Economic Change a professor from the University of Munich writes on agriculture; a professor of theology in Copenhagen describes The Reformation in Scandinavia and the Baltic; a contributor from Bonn discusses the German Reformation to 1555; Delio Cantimori of Florence provides a section of considerable interest on Italy and the Papacy; H. Koenigsberger, now at Manchester, has an essay on The Empire of Charles V in Europe; and the concluding chapter on Europe and the East was writ-

ten by the late Senior Lecturer in History in the University College of Achimota, Ghana.

G. R. Elton, the highly competent editor, provides the general introduction and with learning, insight, and skill evaluates the Reformation. He calls the age "passionate, partisan and narrow" and pointedly recognizes that there are no simple answers to explain its constantly baffling complexities. Elton impresses on his readers the importance of the fact that in the East conditions were in general becoming worse and that there "territories once again became marches against an alien foe." Elton's observations are those of an informed and reflective historian who knows his business and who knows how to handle the problems he must face. The temptation to quote from him at length is great. He takes a firm stand in refusing to credit the age as being the beginning of modern times, but he does see it as the epoch of the ascendancy of Europe, "an ascendancy that the future may well decide came to an end in 1514."

As is bound to be the case with any composite work, all sections do not have similar appeal, yet readers will find each chapter worthy of attention. And the quality of the volume as a whole is high. The pages on Luther, Calvin, Zwingli, the Strassburg reformers and other Protestant leaders will have especial attraction. To appreciate them fully the reader must approach them prepared. They are written for the literate and the informed, certainly not always for the beginner. The sections on eastern Europe are especially welcome, as are those by Denys Hay and A. R. Hall on Intellectual Tendencies and on Schools and Universities. There are riches and delights in this new volume, but the omission of any sort of a Bibliography borders on the tragic.

GRAY C. BOYCE

Chairman, Department of History
Northwestern University

ANDRÉ BONNARD. *Greek Civilization from Antigone to Socrates*. Translated by A. Lytton Sells. Pp. 248. London: George Allen and Unwin; New York: The Macmillan Company, 1959. \$6.00.

Like its predecessor this volume is filled with unusual views dogmatically, sometimes belligerently proclaimed by the author. And he glories in it. "In this work in which everything proceeds by choice, as a matter of chance or calculation I might have 'forgotten' Pindar, as I shall forget many other spirits of an amplitude equal to his" (p. 104). Among those he "forgets"—except for casual references—is Thucydides. To Herodotus, however, he devotes a whole chapter (Ch. 6), yet in that chapter manages to ignore Herodotus' main theme, the Persian War. But only Bonnard could have written: "For the father of history, the acme of the historical would in short be the marvellous guaranteed by reliable witnesses" (p. 127). He rightly calls attention to the conflict in Herodotus between his love of truth and his delight in a good story. However, in making him responsible for the beginning of scientific geography as well as history (p. 126) he deprives Hecataeus and Anaximander of their due.

It would be tedious to dwell on minor inaccuracies, particularly as a number of them have been indicated by the translator (e.g., on pp. 109; 110; 111; 176—though he missed Grote as a "German" on p. 207, n. 1), but sometimes the error leads to false conclusions. In discussing Aristophanes' *Birds* he misses the whole point of the play because he believes it was produced: "... at the moment when Athens, prostrated by the Sicilian disaster ... was getting ready for the final assault ... preparing against her" (p. 188). But the play appeared in the spring of 414, more than a year ahead of the disaster.

At other times he flaunts his opinions in the face of the evidence. This is probably true in his suggestion that in early Greek sculpture both the archaic smile (p. 40) and the statue's immobility (p. 41) were caused not by technical awkwardness but religious feeling. But his remarks about Socrates offer a clearer example. After alluding to the difficulties caused by the prejudices of Plato, Xenophon, and Aristophanes, our best informants, he says: "All this affords plenty of work for the scholars" (p. 217). Then he proceeds to

create his own Socrates, and ignores the whole problem.

His two chapters on Sophocles are perhaps the most rewarding in the book. The interpretation is not conventional, but it is well thought out and supported by constant references. Chapter seven, on fifth century medicine, also deserves special mention. It is well informed and contains a surprising amount of useful information and comment. As the author says, however, it is largely borrowed from the work of L. Bourgey (p. 148, n. 3).

In closing it may be said that Bonnard has produced a work calculated to fascinate the neophyte and to horrify the careful classical scholar. If there is a moral in that I prefer not to point it out.

TRUESDELL S. BROWN

Professor of History
University of California
Los Angeles

ASIA AND AFRICA

ANSLEY J. COALE and EDGAR M. HOOVER.
Population Growth and Economic Development in Low-income Countries: A Case Study of India's Prospects. Pp. xxi, 389. Princeton, N. J.: Princeton University Press, 1958. \$8.50.

This is a book about pie and pie eaters. The pie is India's national income and the pie eaters are the country's population. It is reasonable to expect, the authors say, that the pie will double within 25 or 30 years. If the current birth rate stays the same then, according to Coale and Hoover, the number of pie eaters will also double, and average per capita annual income will remain unchanged. If over the next 25 years the birth rate can be halved, each pie eater in the 1980's will have a bigger piece of pie.

The argument that things will not get much better in India until the population starts levelling off is no longer novel. What is new in this book is the attempt to support the argument with batteries of figures for India's future population and output.

To what extent do these numerical projections deepen our knowledge or understanding of the forces likely to affect the pie to pie eaters ratio in the course of the next few decades? It is immediately apparent that projections are worth neither more nor less than the assumptions which they embody.

Let us look first at Coale and Hoover's economic assumptions. Their discussion of India's economic prospects—the growth of the pie—focuses on the printed volumes setting out the First and Second Five Year Plans for 1951–56 and 1956–61, respectively. They accept, broadly, the plan estimates of the current level of national output. Without exploring the profound uncertainties in national product figures for agriculture, handicrafts, and services, the great bulk of national product, Coale and Hoover are satisfied to make use of the estimates provided in the Plans. They express the opinion that investment and output have been increasing and will continue to increase more or less according to the plan. This judgment reflects quite faithfully, the rosy complacency of New Delhi in 1955–56, the year in which Coale and Hoover visited India. The illusion that things would continue to go forward on the same economic basis and in the same general way underlies their economic calculations. For India, this is the least likely eventuality. The economic position in India in 1955 was at least as delicately balanced as that of the United States in the New Deal year 1935. If any one thing seems certain for India in the proximate future, it is the likelihood of a basic departure—whether Right or Left we need not discuss—from the kind of economic program that Prime Minister Nehru was pushing in the 1950's.

By contrast, Coale and Hoover appear more at home in the chapters on population, the discussions of the number of pie eaters. Nonetheless, the materials with which they have to deal are few and frail. Questions of the future aside, neither they nor anyone else knows with any precision the current birth rate, current death rate, current age distribution, or even total size of the current population of India.

In sum, both the economic and the

demographic data which Coale and Hoover have utilized are subject to appallingly wide errors. The India of our day does not provide the statistical base from which long-range population and output projections may safely be launched.

DANIEL THORNER

Indian Statistical Institute
(Bombay Branch)

RICHARD L. PARK and IRENE TINKER (Eds.). *Leadership and Political Institutions in India*. Pp. x, 486. Princeton, N. J.: Princeton University Press, 1959. \$10.00.

This volume is an important contribution in its field covering as it does a survey of the traditions that may influence contemporary politics in India, a description of such political institutions as the Council of Ministers, the role of parliament in decision making, and an appraisal of political parties. The field of public administration is examined in relation to national planning, the public services, and the Five Year Plans. A concluding section rightly goes to the still basic, socio-political unit in India, the village. A number of rural communities are described from first-hand field work in terms of the role of village leaders, caste, and problems of factionalism.

Specific comment can be made only on a few of the essays in this volume which were originally presented by a group of American and Indian social scientists at a seminar held at the University of California at Berkeley in August 1956. The essay on "Traditional Concepts" by Professor D. Mackenzie Brown seeks to isolate and describe the most potent historical, political concepts that may have relevance to contemporary politics. While affording an interesting background, it seems unlikely that the seesaw of Indian politics is influenced much by the rather nebulous political ideals of the past.

The paper on the "Politics of Modernization" by Professor Myron Weiner is a penetrating analysis of the most striking feature of Indian politics—the presence of charismatic leadership—what would social scientists do without charisma?—the vari-

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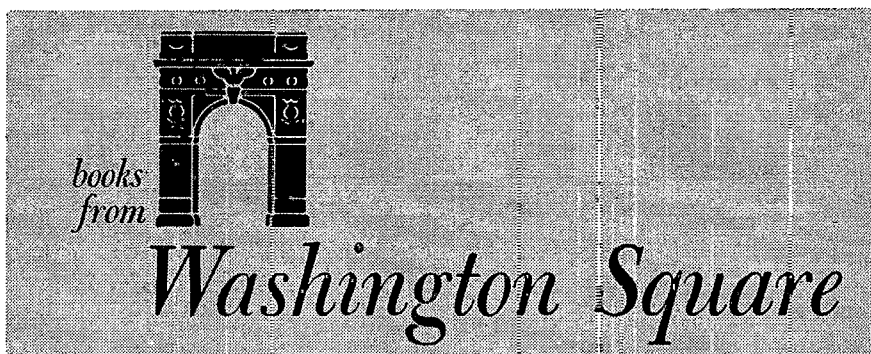
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Edited by Lois MacDonald, Director of the Institute of Labor Relations and Social Security at New York University

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(Coming in December) \$2.50

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ous cleavages in Indian society reflected in politics, the rapid growth of the scope of government, and so forth. Three political personalities have been singled out for biographical treatment: Nehru, Subhas Chandra Bose, and Sardar Vallabhbhai Patel. These are excellent vignettes. The paper on Subhas Bose is one of the best brief studies available on this controversial figure.

All in all, the contributors to this volume give us a valuable insight into Indian political institutions with special reference to the function of leadership. It is, however, interesting that perhaps the most obvious characteristic of this leadership today—its concentration in the hands of a few aging statesmen and the consequent problem of succession—receives little attention in this volume. A recent piece in the *Calcutta Statesman* refers cogently to the "aging team of ministers" at Delhi and to the lack of new leaders who "are not coming up as rapidly as is desirable." This condition is perhaps unconsciously reflected in the three biographical essays on political leaders; two are deceased and Nehru will likely retire from active political life in the next few years.

T. WALTER WALLBANK

Professor of History
University of Southern California

GEORGE ROSEN. *Industrial Change in India: Industrial Growth, Capital Requirements, and Technological Change, 1937-1955*. Pp. xxv, 243. Glencoe, Ill.: The Free Press (for The Center for International Studies, Massachusetts Institute of Technology), 1958. \$5.00.

Rapid economic development is the keynote of national policy in India today. By definition, this would almost involve a change in the country's industrial structure. Development can be intelligently planned only with a thorough understanding of the requirements of capital and labor in the various sectors of the economy and their relationships to output. Authentic studies in this field in India are few and the planning authority had to assume a great deal in making their projections for the five-year plans. Dr. Rosen's book, coming as

it does at a time when the third Five-Year Plan is, in the process of formulation, will provide a firmer basis for all such projections. But its greater contribution will be the stimulus it will provide to Indian scholars to pursue this field of research which is now recognized in India to be most important in planning for economic development.

Several of Dr. Rosen's findings shed a new light on the relationships between capital, labor, and output. For example, his finding that the capital-output ratio for both large and small firms is roughly equal, and possibly lower for the large firms, has a significant bearing on the policy of encouragement to small-scale industries on the ground of relative scarcity of capital. Similarly, his finding regarding the rising capital-labor coefficients and a tendency towards a gradual introduction of labor-saving devices would necessitate a revision of the estimates of the employment potential of new investment. It may be noted that according to Dr. Rosen, the estimates of capital-labor coefficients, both for the investment goods sector and the factory consumer goods sector, made in India by Professor Mahalanobis, appear to be on the low side. Reference may also be made to the author's finding that the hypothesis of "unlimited" supply of labor does not hold true economically in the organized manufacturing sector. Does this mean that in underdeveloped economies in the early stages of development there is not one labor market, but two or probably more?

Dr. Rosen's book has aroused new interest in the economics of industrial growth in India and is currently enjoying high priority in the reading list of economists, both in the universities and in the government.

M. L. DANTWALA

Department of Economics
University of Bombay
India

F. C. JONES. *Hokkaido: Its Present State of Development and Future Prospects*. Pp. viii, 146. London: Oxford University Press under the auspices of the Royal Institute of International Affairs, 1958. \$3.40.

THOMAS C. SMITH. *The Agrarian Origins of Modern Japan*. (Stanford Studies in the Civilizations of Eastern Asia.) Pp. xi, 250. Stanford, Calif.: Stanford University Press, 1959. \$5.00.

These recent studies by Jones and Smith have much in common. The books deal with selected aspects of the economic history of Japan; they have been written by individuals who are primarily political historians rather than economists; the books were urgently needed to shed light on hitherto neglected aspects of Japan's economic growth; the texts are both comprehensive enough to cover the subjects considered without, in general, overlaboring matters; the subjects have been both competently researched and written; and they dispel deeply entrenched illusions concerning their respective specialized subjects. Unfortunately, however, to differing extents, both could have benefited from the constructive criticism of more quantitatively minded colleagues. This last matter detracts relatively slightly from the distinctly praiseworthy and instructive efforts of both authors, efforts which should result in their studies being widely used.

Jones deals with the economic and political history of Hokkaido, its physical and economic geography, postwar development plans and accomplishments, its agricultural and pastoral situation, fisheries and forestry, mineral resources and production, general industrial development and prospects, and the importance of Hokkaido to the economy of Japan. The study appears to rest heavily on materials available in the English language—Ackerman, Lensen, Nasu, Keene, Harrison, and so forth—but these have been strongly bolstered by the impact of three months of travel and "enjoyable experience" on the island in 1954. There are twenty-six tables and five maps in this physically but not intellectually slim volume.

While both the form and content of Jones' study are generally impressive, the book could have been tidied up with respect to statistical matters. Not until page 116, only twenty pages before the end of the text, are readers warned that "... statistical data are none too reliable. . . ." Prior to this, data are directed at the

reader in broadside fashion, with most of them being offered authoritatively as final in type. In a few instances where the author has come across data which conflict with each other, the reader is presented with Jones' choice of one figure over the other without the basis for the choice (for example p. 86, Table 20; p. 87, Table 22). Nor are the data presented in a uniform fashion. Since 1 *cho* = 2.45 acres, 247 acres = 1 square kilometer, and 640 acres = 1 square mile, why could not acres have been used in lieu of *cho* and square miles used in lieu of square kilometers uniformly throughout the study instead of the units being used alternately in apparently indiscriminate fashion. In a similar vein, either dollars or pound sterling should have been used as a measure of value in relation to the *yen* but not both alternately (p. 60). Also, 1,580,000 *che* is not "pretty much the same" as 1,450,000 hectares (p. 58, f.n. 1), it is larger by 8 per cent—roughly 290,000 acres—in absolute numbers. Lest these remarks be misunderstood, it needs to be reiterated that the study is well done, and students of economic development will find it rewarding. The experiences of United States General Horace Capron in Japan in the 1870's, for example, have an almost current Foreign Operations Administration and International Cooperation Administration-like ring to them (pp. 1-14 *passim*).

Smith's analysis of the traditional village in Japan and the impact on it of the growth of markets, the development of agricultural technology, the transformation of labor, the development of new class relations, and so forth rests on a wide variety of micro-type data: family journals, village reports, oral and written traditions, and the literature of the times. Parts of the book are based on original materials, most of it is based on the research of Japanese scholars who collected and studied these raw materials, and practically all of it is based on writings in the Japanese language. Both Smith's scholarship and writing leave a distinctly good impression and the desire to see more of his research efforts. There are a number of very minor criticisms which can be made

but these are hardly worth mentioning. Smith as well as Jones has produced an excellent addition to any library of East Asian studies.

SIDNEY KLEIN

Assistant Professor of Economics
Rutgers, The State University

SHAO CHUAN LENG. *Japan and Communist China*. Pp. ii, 166. Kyoto: Doshisha University Press, 1958. Distributed by the Institute of Pacific Relations, New York. No price.

The Peking regime's impact on its Asian neighbors is insufficiently reflected in Western literature on international affairs. This statement certainly applies to the case of Japan.

Despite the obvious significance for the balance of power in Asia of Japan's foreign policy orientation, few American scholars have attempted to evaluate the changing relations between Communist China and Japan.

Dr. Leng's book thus is something of a pioneer effort in an important field. The author bases his analysis in the main on Chinese and Japanese periodical literature and official documents, supplementing these sources with personal interviews conducted in Japan during 1956 and 1957. The study was concluded at a time when Japan's economic position seemed more vulnerable to the lure of Chinese trade than it is today, and when the Peking regime's policy toward the Kishi cabinet was less aggressive. This may explain why some of the author's short-range forecasts do not always stand up against current developments.

Dr. Leng modestly calls his work a "suggestive survey." Actually the study is an exceedingly useful and, despite its brevity, a surprisingly comprehensive treatment of the first six or seven years of relations between Communist China and Japan.

Starting with a chapter which provides the setting for the subject, the author proceeds to a discussion of Peking's "people's diplomacy" toward Japan, then takes up in considerable detail the economic relations between the two countries, touches

upon the repatriation of Japanese and Chinese nationals, and offers a brief survey of official and unofficial political contacts. A chapter on the Japanese reaction to Communist China generally confirms the findings of C. Martin Wilbur's lengthier treatment of the subject in the book by Hugh Borton and others, *Japan between East and West*. The author's views on the future outlook for Sino-Japanese relations, and several useful documentary and statistical Appendices round out the presentation.

Currently, relations between the Kishi cabinet and the Mao regime are at an all-time low, a development that was perhaps not fully anticipated in Tokyo when this book was written. On the other hand, the Japanese government's ability to withstand the Communist bloc's propaganda pressure and its unwillingness to make political concessions despite Peking's suspension of trade with Japan, may have come as a surprise to the Chinese Communist policymakers. While the final outcome of this test of strength is difficult to predict, the present situation suggests that the economic factor, in the near future at least, will be somewhat less important in shaping the relations between the two countries than one might have thought only a few years ago.

PAUL F. LANGER

Assistant Professor of International
Relations and History
University of Southern California

ARTHUR WALEY. *The Opium War Through Chinese Eyes*. Pp. 257. New York: The Macmillan Company, 1959. \$4.75.

The present work is the first venture into the field of history by the well-known translator of Chinese literary works. It is the translation of selections of a collection of historical documents on the Opium War, published, some for the first time, in *Ya-p'ien chan-cheng tzü-liao ts'ung-k'au* (*Corpus of Material about the Opium War*, Shanghai, 1955).

Part I (pp. 11-157) is the translation of selected passages covering the period from February 1839 to July 1841 from the

diary of the special opium commissioner, Lin Tse-hsu, whose uncompromising attitude, instead of suppressing the opium traffic, led to the conflict with the British. Part II (pp. 158-186) contains the translation of the *Tu-tu yin* ("Songs of Oh dear, Oh dear!") describing the ill-fated Chinese counteroffensive under General I-ching against Ningpo, by Pei Ch'ing-ch'iao, an officer on I-ching's staff. Part III (pp. 186-196) is the translation of a diary recording thirteen days, June 16-28, 1842, of the British invasion of Shanghai, by the scholar Ts'ao Sheng. Part IV (pp. 197-221) is a description of the British occupation of Chingkiang from July 8 through October 4, 1842, based on the diary of the poet, Chu Shih-yun. Part V (pp. 222-243) gives the biographies of Charles Gutzlaff and of some of his collaborators.

While Mr. Waley's work is written "chiefly for the general reader" and is limited in scope, not attempting "to give a complete and consecutive story of the war" but only as viewed through Chinese eyes, it is historical in nature and must be judged as such. In this connection the following remarks must be made. By annotating the Chinese accounts and by comparing them with accounts from Western sources, mostly British, Mr. Waley gives us the story of *The Opium War Through Chinese Eyes* but British-colored glasses. The absence of a more complete Bibliography and of footnotes authenticating statements drawn from non-Chinese sources is regrettable. There are also minor inaccuracies throughout the book. For example, *Yueh hai-kuan chih kao* is translated as "History of the Customhouse at Canton" while it should be "Draft Gazetteer of the maritime customs of Kwangtung"; *Chih-fu* is Prefect and not Governor; *Chih-hsien* is District Magistrate and not Prefect, and so forth.

In spite of these shortcomings Mr. Waley's book is a contribution. It is the most balanced of all British accounts of the Opium War.

JOSEPH S. SEBES

Assistant Professor of History
Georgetown University

WARREN S. THOMPSON. *Population and Progress in the Far East*. Pp. ix, 443. Chicago: University of Chicago Press, 1959. \$7.50.

Over the last four decades Warren Thompson has been a dedicated and compassionate student of the increasing populations of the Far East. Now, in nominal retirement, he has seen and studied the countries of the Far East as they are today, assessed and judged their policies and prospects, and weighed the possibilities for progress in the various countries. In *Population and Progress in the Far East*, there are no summaries of past works, and there is no lament for the Far East as it might have been if the warnings of past decades had been heeded. There is, instead, a series of current pictures on broad canvasses. Regionally, they cover Japan, India, China, Pakistan, Ceylon, the mainland and island Southeast Asian countries, Taiwan, and Korea. Topically, each country analysis includes location; area and resources; agricultural status, developments, and prospects; industry and plans for industrialization; and prospects and probabilities. Population is included, but it is integrated with the total situation in a focus on probable rates of population growth and the likely relations between feasible increase in per capita income and the fulfillment of the expectations of the people for better lives and more abundant living.

Since summary is impossible, three of the recurrent conclusions in country studies and general analyses may be stated in somewhat too categorical a form. 1. The basic problems in securing rising per capita income are social and cultural rather than directly economic. 2. The essential course to economic development in the agrarian Asian countries lies in increasing agricultural productivity, and then utilizing the rising product from agriculture to sustain industrial growth. The case of Japan is examined in some detail as indicating the feasibility of economic growth in the Far Eastern setting if the path is followed. 3. The pressures of populations create tensions and expansionist activities among those nations that have the power to ex-

pand into the territories of their neighbors. 4. "In the long run . . . the only sure relief for population pressure and the tensions and troubles it creates is population control" (p. 399).

The title, *Population and Progress in the Far East*, suggests that Warren Thompson's views of the prospects for the Asian countries are optimistic. On the contrary, there is deep pessimism concerning the next few decades. The probabilities for the development of adequate food supplies are not encouraging, and economic developments will not be rapid enough to prevent increased feelings of population pressure. Emigration on a sufficient scale is not possible. Dependence on foreign trade cannot ease population pressures, and it is economically and politically precarious. The control of population is essential, but not even India is making the major efforts essential to the reduction of birth rates. Thus the broad conclusions are somber. Over the next generations, limitations to expansion in production and continuity or quickening in population growth are likely to bar much improvement in living conditions. Felt population pressures are likely to increase significantly.

IRENE B. TAEUBER

Office of Population Research
Princeton University

J. S. FURNIVALL. *The Governance of Modern Burma*. Pp. iv, 132. New York: International Secretariat, Institute of Pacific Relations, 1959. \$2.50.

Students of postwar Southeast Asia will welcome Mr. Furnivall's thoughtful comments on the structure and functioning of Burma's government. The introductory chapter covering background considerations includes a cursory description of British colonial administration, the effects of the Japanese interregnum, and problems attending temporary postwar British control and eventual transfer of power to Burma's Anti-Fascist People's Freedom League (AFPFL) leadership. This is followed by three detailed chapters describing the central government, local administration, and regional—non-Burman—rule, viewed from both the constitutional and the practical

point of view. These four descriptive chapters, written in 1957 and early in 1958, are apologetic in tone, stressing objectives over actuality. Only the Introduction and the concluding post-mortem chapter take into account the debacle of the AFPFL regime down to September 1958.

Mr. Furnivall stresses the inherent contradictions between Burma's parliamentary and liberal aspirations, its bureaucratic tradition inherited from colonial times, and the concern of postwar leaders to achieve a welfare state limiting individual initiative and utilizing state capitalism as the means of economic development. These conflicting objectives were to be realized, furthermore, in a state ruined economically by the war and plagued by continuing disorder, and by youthful leadership lacking in both administrative and business experience. While conceding the basic validity of Mr. Furnivall's analysis of the problem, the account is vulnerable to criticism not only from its consistently apologetic tone but occasionally on grounds of inaccuracy. It is questionable whether "frozen commercial interests" held the balance of legislative power from 1937 to 1941, whether Dr. Ba Maw's wartime regime exercised real administrative initiative, or that all British military men—not to mention Governor Dorman-Smith—respected General Cueng San in 1945. More surprising is the author's characterization as "more democratic and efficient" the completely ineffective, party-dominated pyramiding of local councils, soviets, initiated in 1953, which threatened to destroy the entire traditional administrative structure.

The final chapter explaining the breakup of the AFPFL government from May to September 1958, is written in a mood of sadness reflecting the author's dedicated concern for the well-being of Burma and her people. Here he deals with political realities—personal feuding and distrust, competition between mass organization factions, the lack of genuine authority in Premier Nu's government—all of which were eagerly ignored in the preceding chapters. Not explained are Nu's initial concern to deprive his Socialist party oppo-

nents of their control over the Union Military Police, and the role played by this same body in precipitating the regular army's take over in late September 1958. Incidentally U Kyaw Dun's name is consistently misspelled. Another omission is Nu's desperate effort to maintain a parliamentary majority that involved making sweeping promises to dissident Arawanese and Mous, the release of Communist M.P.s from jail, and, finally, political partnership with the pro-Communist National Unity Front. The account is a most welcome contribution to recent history, but it is hardly the last word on the debacle of the AFPFL coalition government.

JOHN F. CADY

Professor of History,
Ohio University

ANDREW COHEN. *British Policy in Changing Africa*. (Northwestern University African Studies, No. II.) Pp. x, 116. Evanston, Ill.: Northwestern University Press, 1959. \$4.50.

Sir Andrew Cohen deserves a good share of the credit for the relatively smooth transfer of power from Britain to Ghana. He was also behind the scenes in the Colonial Office at the time of the conception of the federation of Rhodesia and Nyasaland. Before assuming his present role as British representative on the United Nations Trusteeship Council, Sir Andrew was Governor of Uganda through a period of social and economic advance as well as political turmoil.

Men most qualified to speak are often the most reticent. Sir Andrew is not timid by nature or deed. He rejects the Marxian interpretation of inevitable exploitation by all colonial powers. While criticizing Americans for oversimplified attacks on colonialism, he admits frankly that British policy in Africa has grossly underestimated the time available before self-government. Now it becomes clear that the time is too short for indirect rule through chiefs to evolve easily into a democratic pattern. African nationalism is more urban than assumed by British policy. The pattern has been to build carefully a firm foundation. Often this is done by first resurrect-

ing traditional institutions as supports, and then, under the threat of storm clouds, hastily to put on the roof. No wonder some of the resulting structures are held up primarily by military power as in the Sudan.

Sir Andrew is most cogent in discussing the development of almost wholly African countries. His omission of British policy in Southern Rhodesia, Northern Rhodesia, and Nyasaland may reflect a lack of solutions for parts of Africa where policy must penetrate hide-bound Europeans, or the inadvisability of making such policy explicit in lectures, such as these for the Northwestern University African Studies Program.

Sir Andrew wisely concludes that the United States and Britain "have a co-operative job to do. To do it successfully we need to understand each other and the nature of the job." This handsomely produced book is an excellent contribution toward that goal, and one for which the Northwestern African Studies Program is to be congratulated.

EDWIN S. MUNGER

African Associate
American Universities Field Staff
Kampala, Uganda

PIERRE MONTET. *Everyday Life in Egypt in the Days of Ramesses the Great*. Translated by A. R. Maxwell-Hyslop and Margaret S. Drower. Pp. xvi, 365. New York: St. Martin's Press, 1959. \$8.00.

Professor Montet, who is a respected authority in Egyptology, has given us, in this volume, a summary of the home and family life of the common man, the aristocrat and the pharaoh, as well as their environment in the city and country; he comments on the calendar and time awareness, the travelling facilities, the attitude of the Egyptian toward the foreigner, the hardships he suffered in the desert, mining in the mountains, and on the sea. Then follows a description of the pharaoh's daily schedule in affairs of state and religion, his occupations and diversions, the intrigues of harem and palace. The most complete survey is devoted to the soldier of the army and an account of his equip-

ment, climaxed by an excellent description of the battle of Qadesh. After a review of the government and its officials, the book comes appropriately to an end with the story of religious festivals and the rites of burial. The work is furnished with excellent References, a Glossary, Abbreviations, and a general Bibliography.

First and foremost, the general reader will find a bone of contention in the title of the book: the author, drawing heavily, as he must, on the earlier periods of Egyptian history, could easily have included in his title the whole panorama of daily life from the first dynasty to the Ptolemies. Granted that many changes were made in cultural expression from the first to the nineteenth dynasty, the common denominator was more constant on the Nile than in any other ancient civilization. The most obvious lacuna is the omission of spinning and weaving, and we know the Egyptian was more than proud of his linen fabrics; no mention is made of the manufacture of glass, which was such a delight to Breasted; very little is said about the craft of the sculptor and nothing about the painter's work on the walls of tombs. The crowns of the pharaoh are confused (p. 198), and business life, I'm sure, was not always "a very laborious affair" (p. 168).

Professor Montet has, however, woven together an interesting pattern of pictures from literature, art, inscriptions, and tools. He is evidently a scholar whose imagination reaches beyond pedantic cataloging and enumerating; though some authorities would lift a quizzical eyebrow, why should he not state, if he has some reason for so doing, that Ramesses II was the oppressor of Israel (p. 161), and that he knows the approximate location of Punt (p. 183)? He adds some interesting information from his own area of work, for example, the roofing and the viticulture of the north. The book will, beyond a doubt, make stimulating reading for the student approaching the rich heritage of Egypt for the first time.

ELMER G. SUHR

Professor of Art and Archaeology
University of Rochester

SOCIOLOGY AND EDUCATION

C. WRIGHT MILLS. *The Sociological Imagination*. Pp. 234. New York: Oxford University Press, 1959. \$6.00.

Social scientists tend to define themselves as members of one of three loosely related clans pursuing quite diverse occupational goals and *modus operandi*: the Pure Scientists, the Actionists, and those who seek Significance. The epistemology of the Pure Scientist is extracted from the logic of experimental inquiry; his favorite glow word is "empirical" by which he ordinarily means quantitative; his devil-symbol is "arm-chair philosophizing"; and his chief conceit is that in contrast to the "tender-minded" who seem always to be babbling about value problems he himself is quite above any such untidy preoccupation with moral issues. The Actionists and the school of Significance, on the other hand, are alike in their willingness to subordinate considerations of austere conceptual clarity and methodological nicety to the demands of an agonized social conscience. But where the Actionists are content to dwell in a finite world in which as middlemen of the mind they translate the knowledge of the social sciences for the benefit of social work the more ambitious votaries of Significance serve as liaison men between social science and social philosophy. The Actionist "solves problems"—he deals with the maladjusted child, the alcoholic, the employee with poor morale. The man of Significance "illuminates issues"—he deals with freedom, alienation, crisis.

The Sociological Imagination is essentially a polemic in which a gifted and prolific advocate presents the case for Significance. Mills believes that social scientists have the obligation to illuminate the nature of private troubles and public issues confronting contemporary men. Many of these arise as a consequence of the altered conditions of social control in our time. Power structures become increasingly difficult to locate, let alone control, and the emergence of the Cheerful Robot testifies that although we have become progressively more rational, that is to say bureaucratized, we are scarcely more free. Responsible

social science, then, entails specifying the conditions under which freedom and reason are possible.

A task of this magnitude can be performed only by possessors of the "sociological imagination," those who conceive their task to be the extension of the classic traditions of fruitful sociological inquiry. According to Mills, "biography, history, and their intersections within social structures" should always provide the "coordinate points of the proper study of man." The major requirement, then, for productive enterprise in social science is that the individual scholar shall be endowed with a mind sufficiently sensitized by erudition, subtlety, and moral urgency to permit him to range freely across all levels of analysis in order that he may comprehend finally not only the concrete facts of individuality and immediate milieu but also social organization in its largest meaningful units and time measured in epochs.

Most of Mills' book is a spirited and incisive demonstration of the delinquencies of contemporary social science as measured by the standard of the "sociological imagination." The chief villains turn out to be protagonists of "grand theory" and "abstracted empiricism," standard bearers of what I have called the Pure Scientists, and also those social scientists, the Actionists, who wrestle with segmental problems or act as philosophers for the kings of power. Along the way Mills has some jolly fun with parsonian prose, the microcosmic view of the operationists, and with scarcely concealed relish identifies some bureaucratic types whose resemblance to live sociologists is most assuredly intentional. His most trenchant critique is reserved for the Pure Scientists: "A conception is an idea with empirical content. If the idea is too large for the content, you are tending toward the trap of grand theory; if the content swallows the idea, you are tending toward the pitfall of abstracted empiricism."

The nonprofessional who is witness to the fiery rhetoric of the schools might well conclude that they deny each other any intellectual merit whatsoever. He would be mistaken. Even the most orthodox Pure Scientist can be beguiled into an ad-

mission that Reisman and Mills have "germinal minds and their work while not really science is often useful for hypothesis formation." For their part, the Big Issue sociologists will concede that the man who stands, clicker in hand, at the Mason-Dixon line, counting migrants "while not engaged in genuinely scientific activity does perform a certain housekeeping function." In effect, much of the heat generated by the disputants depends on counterclaims concerning who more legitimately has the right to speak in the name of a single honorific symbol, science. But surely this is a matter of surpassing triviality unworthy of the detailed attention of serious men.

Perhaps we would do better to think in terms of the common device of popularized general semantics and employ subscripts to distinguish between various types of social science. We might then be more generous in providing both adequate opportunity for graduate training and also for subsequent equal reward in the coin of the scientific and secular realm for able practitioners in all types of social analysis. Grand theory, abstracted empiricism on a large scale, and the emergence of actionists in assorted bureaucracies are largely of post-World War II origin—only classic analysis has been given an extended trial. I do not believe that it is too innocently nineteenth century to proclaim that at present our major obligation is to find the appropriate administrative arrangements which would allow all tendencies in social science to compete in the marketplace of ideas. Is it naïve to require professors to reject the ethos of bureaucratic thrust and counterthrust in favor of the liberal standards of the academy?

MARVIN BRESSLER

Associate Professor of Sociology
New York University

ROBERT K. MERTON, LEONARD BROOM, and
LEONARD S. COTTRELL, JR. (Eds.). *Sociology Today: Problems and Prospects*.
Pp. xxxiv, 623. New York: Basic Books,
1959. \$7.50

In planning the annual meeting of the American Sociological Society for 1957, the program committee decided to build the

sessions around a review of the present state and trends of sociology. To the chairman of each section was assigned the task of providing a paper focussing upon the work of a major subdivision or aspect of developments in the field. After the critical discussions of the section sessions, those papers were to be revised and sharpened for publication in a single volume to serve as something of a baseline for an appraisal of developments and problems of sociology. The result is *Sociology Today*, edited by the president of the Society and the editors of the two journals published by the Society.

This is a volume which, short of available space for a critical appraisal of each unit contribution, is most adequately reviewed by the simple statement of its purpose amplified by a list of its distinguished contributors. Each of them is recognized as a representative of a major area of specialization. The fact that more than 10,000 copies were purchased in the first few months following its release is one measure of its usefulness to everyone who wants to know what sociology in America is doing.

In a volume which brings together the work of twenty-nine authors, there is an impressively high standard of performance. The editors have wisely avoided any attempt to present the separate unit studies in anything but an expedient order. They have grouped the items included under five headings: 1. Problems of Sociological Theory and Methodology; 2. Problems in the Sociology of Institutions; 3. The Group and the Person; 4. Problems in Demography and Social Structure; and 5. Selected Applications of Sociology. Despite the misleading impression of a potpourri or encyclopedic coverage, the fact is that these studies do demonstrate, not in their sequence as chapters, but in their problemization with all its range and conceptual variability; the unity of an enterprise. With his felicitous clarity, Robert Merton has provided a unifying orientation to what may seem a bewildering array of specialties in a reference on the formulation of problems. The fact remains, however, that the manifest unity is in the way the parts gear into one another as a field. Here is no

overweighted emphasis upon methodology, even where the tools and the skills of the research technician are a major concern. Qualitative studies set the pace along with the quantitative studies. One finds recurrent assignment of priority to the need for theory and its more adequate formulation. One of the values of this as a synopsis of a field is its faithful mirroring of the vigorous state of probing and growth, with all of its unevenness of conceptualization and the level of problemization.

Finally, it is worth underscoring that *Sociology Today* is not merely a report or a series of reports on the record. At least eight of the twenty-five chapters interpreted the assignment so flexibly that the subject matter is substantial material not previously reported. Even the other two-thirds of the chapters deal not only with the state of the specialty but appraisal and trend projection. The volume will be a much-used resource for the sociologist. For others who want to keep abreast of the field, it will serve as a guide to forthcoming developments in theory, research, methodology, and the sharpening specializations of sociology.

WELLMAN J. WARNER

Professor and Chairman, Department
of Sociology and Anthropology
New York University

FLOYD HUNTER. *Top Leadership, U.S.A.*
Pp. xvi, 268. Chapel Hill: University
of North Carolina Press, 1959. \$6.00.

Readers with any interest in the topic of leadership—or knowledge of the mountainous and often banal literature on the subject—will welcome this fresh focus on persons and groups who color and influence issues from local to national levels.

Generalizing from data collected on transcontinental shuttles, Professor Hunter embraces, in *Top Leadership, U.S.A.* all grades and levels of policy and decision makers who form the multiple and interlinked power pyramids essential for winning social goals.

His thesis is that powerful individuals "willing that things be done or not done" must unite with other similar persons to achieve their socially allowed objectives. In the process a small group of peers—

not an oligarchical conspiracy—unofficially has its will and purpose carried out by the many who defer to it. Similar interconnected structures are shown operating at community, state, and national levels, as well as in a specific industry such as housing, on specific issues, and in corporations. The essential cement inside and between structures, as well as from level to level, is informal and personal contact. Power in action becomes a “fan-out affair” wherever initiated. In the community, a circuit of more influential persons—policy shapers, opinion leaders, decision makers, and so forth—represent the largest industries, banks, law firms, commercial houses, and newspapers. As a nuclear group they call in politicians, educators, clergymen, and labor leaders for conferences on community issues. Since there are revolving committees of leaders linked with other similar clusters, the community’s policy making structure is a multiple, not single, pyramid of power.

Top leaders in communities, states, regions, service organizations, and industrial complexes come to know and assess each other and to engage in joint actions on the basis of individual fitness, interest, and recognition of a claims system in which all function. But where Hunter implies absence of collusion and corruption in the actions of his informants and subjects (pp. 157–158, 213), this reviewer would suspect varying degrees of calculation and improbity that are checked by more responsible members.

The central finding is that “leadership” cannot be pinned down to the formal operations of offices and organizations. A gap exists between planned and working action, as well as between our tradition of equality among individuals and their influence in practice.

Most specialists will be pleased with Hunter’s detailed enumeration of steps in the research, effective use of sociograms and informants’ comments, and his ranking of leaders by occupation.

MELVILLE DALTON

Associate Professor
Department of Anthropology
and Sociology
University of California, Los Angeles

WILLIAM MCCORD and JOAN MCCORD with IRVING KENNETH ZOLA. *Origins of Crime: A New Evaluation of the Cambridge-Somerville Youth Study*. Pp. xvi, 219. New York: Columbia University Press, 1959. \$6.00.

One of the largest experimental attempts to prevent juvenile delinquency—the Cambridge-Somerville Youth Study, 1939–1945—treated by various kinds of counselling 325 boys matched with 325 untreated boys. The now famous results of the experiment were discouraging: no significant differences were found to exist in major areas of adjustment among the treated boys compared with their controls.

The McCords’ book reports their findings in an analysis of data contained in the files of the study, with reference to further criminal behavior which occurred between 1945 and 1955 among an attenuated group of 253 treated boys. Convictions in Massachusetts courts were used as the criterion of criminality, and they revealed that 41 percent of the treated group and 37 percent of the control group had been convicted of at least one non-traffic offense by 1955. Furthermore, the groups experienced convictions for approximately the same number and kinds of crimes, and a tendency for decreasing criminality at similar rates in similar age categories was observed.

In the book’s remaining analyses only the treated youths are considered, since the data obtained from the controls were too scanty. Subjected to detailed statistical scrutiny were treatment factors—intensity and duration, number of counsellors to which each boy was exposed, and so forth, and personal-social factors—intelligence, physical condition, social circumstances, home atmosphere, discipline, parental character and relationships. Types of criminal acts and age at first criminal behavior were also examined in their correlations with personal-social factors.

A general summary of the authors’ multitude of findings is that, “the absence of parental affection [makes] a child prone to delinquency,” and that, “family conflict, inconsistent discipline, and the influence of parents who themselves rebelled against the standards of society [lead] to crimi-

THE MAN:

DAGOBERT D. RUNES

Former director of the Institute for Advanced Education and editor of *Journal of Aesthetics*, *Philosophic Abstracts*, and *The Modern Thinker*, Dagobert Runes has won international renown as philosopher, scholar, author and lecturer. He is the author of 20 books, including *Twentieth Century Philosophy*, *On the Nature of Man*, *Letters to My God*, and *Dictionary of Judaism*.



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THE RECORD: The writings of Dagobert Runes, from which this book is largely drawn, have received such comments as these:

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— ALBERT SCHWEITZER

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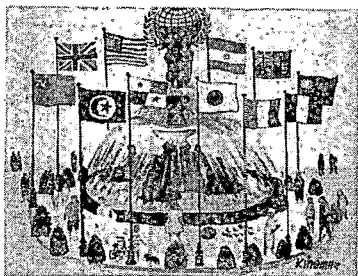
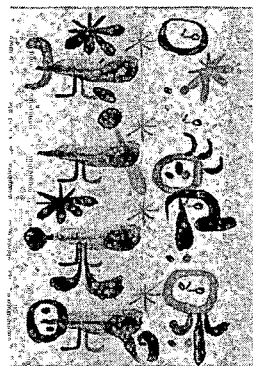
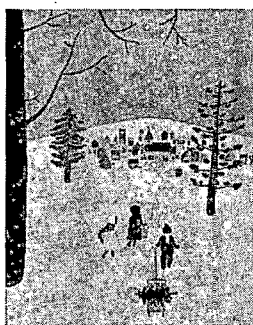
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nality." The authors recommend specific treatment measures for specific types of criminals, based on their presumed demonstration of respective etiological processes. Thus, property offenders require attention, recognition, and nonpunitive discipline, while sex criminals need approval and affection. The McCords unfortunately used a highly questionable classification of offenses: included within property crimes were illegal possession of firearms, vagrancy, violation of game laws, and non-support. Crimes against the person included armed robbery but excluded rape and abuse of female children. Sex crimes included illegitimacy.

While the authors deserve credit for their very informative follow-up on the boys' later criminal careers, the study contains at least one serious weakness. The McCords' method of analysis was to determine, for each factor-category, the rates of conviction of boys classified within its subcategories, and then to test the statistical significance of the distribution. But where intercorrelations between factors exist—and common sense indicates many in this study—then a presumed finding of a relationship between a factor and a particular conviction rate may be spurious. Techniques exist for grouping variables to minimize this difficulty, but the authors used them in only a few of their many computations. Consequently, their conclusions and recommendations for preventing delinquency must be regarded skeptically.

RALPH W. ENGLAND, JR.

Assistant Professor of Sociology
University of Illinois

MORRIS JANOWITZ. *Sociology and the Military Establishment*. Pp. 112. New York: Russell Sage Foundation, 1959. \$1.50.

In this report, published for the American Sociological Society, the author briefly reviews the surprisingly limited sociological literature on the American military establishment. He devotes the bulk of his study to a description of the basic trends which are transforming military institutions in the United States.

Janowitz first outlines some parallels and contrasts between military and civilian variants of bureaucratic organization. Several

fresh insights are offered. For example, the author points out that the current militarizing of American society entails to some extent the civilianizing of the military establishment. He also explores the increasing complexity of the military skill structure and its relation to the class structure of modern society. This relationship is compared with that prevailing in feudal society.

We can mention only a few of the other findings of this report. Technical specialization, in the army as in modern industrial society, has made for an increasing proportion of middle-rank personnel. Co-ordination of specialties rather than orders to inferiors has become a major part of the military commander's job. Indeed, the complexities of the new technical skills tend to clash with the traditional hierarchies of military authority. More initiative must be granted to individuals and to small local units—and therefore more awareness of the operation and aims of the whole organization must be conveyed to individual members by better training methods.

A trend from nomination to manipulation, says Janowitz, characterizes military as well as civilian bureaucracies.

A chapter on the assimilation of military roles identifies the barriers and incentives to recruitment. Conventional methods of testing personnel for military leadership come in for sharp criticism. Another chapter deals with the significance of small groups for military organizations, and with the responses of such groups to stress.

Sociology and the Military Establishment sketches some important social changes in modern military machines. It is a well-written report, with many stimulating insights. In such a short work, omissions of relevant material are inevitable. Perhaps the chief shortcoming of the bulletin is its failure to grasp the present historical situation of American society. The militarizing of American society can scarcely be analyzed comprehensively without considering the specific relations of American capitalism to war and to the social revolutions abroad. Nonetheless, Janowitz approaches his subject critically and independently. Many of the sociological studies he cites, however, indicate an un-

fortunate tendency on the part of social scientists to become technicians—efficiency experts—uncritically serving the military ends of American national policy.

ARTHUR K. DAVIS

Chief Research Officer
Center for Community Studies
University of Saskatchewan

MELFORD E. SPIRO with the assistance of
AUDREY G. SPIRO. *Children of the Kibbutz*. Pp. xix, 500. Cambridge, Mass.: Harvard University Press, 1958. \$10.00.

The *Kibbutz* (in the plural, *Kibbutzim*), a voluntary, collectivist, socialistic, primarily agrarian settlement in Israel, presents a most interesting phenomenon in the global march towards the welfare state. The *Kibbutz* was born out of the realities of the upbuilding of the Jewish national home, of the dreams of Tolstoyan self-labor, socialism, and the Jewish tradition of social justice. It became a powerful mainstay of the Jewish community in Palestine under the British mandate and a most important factor in the achievement of Israel's independence and its defense.

The *Kibbutz* also offers proof of the feasibility of voluntary collectivist forms of living in contrast to the cruel, forced communist collectivization. The *Kibbutzim* are organized in several groupings differing in their political and political-religious ideologies. However, there is much latitude in experimentation in the individual settlements.

Child rearing in the *Kibbutz* has been a fascinating subject for research, particularly in the psychiatrically-oriented disciplines. Its radical breakaway from the norms of both the Western and the traditional Jewish cultures, the latter in its various stages of westernization, has been manifested most drastically in the far-reaching replacement of the parents' role by that of nurses and educators, the application of psychiatric theories in child rearing, including, for instance, attempts to circumvent the oedipus complex, an accepted dogma in many circles, and in other ways. All these have elicited the attention of scholars in Israel and abroad.

The weighty study by Dr. Spiro, a Freudian American anthropologist, follows

his earlier work, *Kibbutz: Venture in Utopia* (Harvard University Press, 1956). Its locale is a village belonging to the Hashomer Hatzair movement, an idealistic Mapam pioneer group, puritanic in its addiction to an outdated synthesis of Orthodox Freudianism and Marxism.

In their pioneering stages, the *Kibbutzim* have always had to struggle against terrific odds, greater than those faced by the Hutterites and similar groups in America. Israel is surrounded by neighbors who intend to exterminate the Jews. The *Kibbutzim* usually occupy the front line in a country where the front is almost everywhere. They have suffered from attacks and warfare. They have faced and continue to face physical dangers, difficulties in the absorption of newcomers, lack of manpower of nurses and teachers, intermittent ideological disputes, and the ever present lure of the cities. Thus the *Kibbutz* has never been a really sheltered laboratory.

Spiro's study which covers the entire span of education from the nursery to the emergence of the young adult member of the *Kibbutz* not only offers a detailed description and critical analysis of a child-centered culture, but also constitutes an important contribution to general education. It is most regrettable that space does not permit me to summarize it more adequately, particularly since it is based on close and minute observation on the spot.

Kibbutz education is basically institutional upbringing. The infant is separated from its mother upon birth. Although she feeds it and together with the father plays with it regularly, the infant's true home is the play pen or dormitory, and its peers constitute its extended family, just as the *Kibbutz* is that of the adults. The basis for this arrangement is ideological as well as economic. This does not imply absence of parental love. It is quite possible that upper class American children may receive less evidence of parental love, and children of working mothers less attention. It would seem, according to various studies, that *Kibbutz* children appear to be retarded until the age of six, with ensuing psychic disturbances. Later, such manifestations are overcome.

The reader is apt to feel that *Kibbutz* education presents too many difficulties. The study reveals, for instance, that it leads to introversion, insecurity, aggression, sometimes expressed in insolence. The *Kibbutz*-raised *Sabra*, the native Israeli Jew, is conservative in his sex attitudes. After brief pre-marital sex experiences, he marries young and stays married. He accepts the *Kibbutz* as his way of life without the ideological enthusiasm of his parents, and not without ambivalence about its opportunities and limitations. He prefers physical work as a duty and avoids professions. He is relatively indifferent to politics. Despite his aversion to religion, he insists on a religious marriage ceremony. Like many other *Sabras*, he shows little interest in the Jews outside of Israel.

The product of *Kibbutz* education is a co-operative man, who is very devoted to his family, his settlement, and his people, and who takes his obligations seriously. His heroism in pioneering and on the battle front is well proven. No data are available to permit comparison with young people raised in other *Kibbutzim* and societies. Regrettably, the number of young adults studied is insufficient to arrive at definite conclusions.

Hashomer Hatzair, in my opinion, is more rigid in its ideology and its culture patterns than other groupings. This may account in part for the manifestations shown. The less dogmatic *Kibbutzim* seem to have solved the problem of child education in better ways.

For better or worse, the *Kibbutz* continues to be the most important effort at social living that represents voluntary collectivism. Fortunately, *Kibbutz* educators are most touchy on the subject of their children and generally accept criticism by experts. It is to be hoped that the points raised by Spiro will be taken into consideration by the educators. Until we have more comparative data, the final verdict over *Kibbutz* education cannot as yet be passed.

ABRAHAM G. DUKER

President and Professor of Social
Studies
College of Jewish Studies
Chicago

RASHI FEIN. *Economics of Mental Illness*. (Joint Commission on Mental Illness and Health, Monograph Series No. 2.) Pp. xx, 164. New York: Basic Books, 1958. \$3.00.

Most psychiatrists are too busy trying to help their patients to pay attention to the costs of mental illness. A few hospital administrators are only too well aware of the cost because of their chronically inadequate budgets. This small but excellent book will direct attention to this problem and help to explain budget insufficiencies. In this study for the Joint Commission on Mental Illness and Health, Dr. Fein first details the tremendous cost of mental illness—3,000,000,000 dollars every year when both direct expenditures and indirect losses are accounted for. Yet even this huge figure omits some large items, particularly the costs of such neurosis, personality disorder, and behavior disorder in children which never require hospital care, and the costs of increasing quantities of medications taken by millions throughout the country. He delineates methods by which he arrives at his conclusions so that others may repeat his estimates, or refine them. His is as much a study in methodology as in statistical findings. From this point of view alone it is invaluable. In addition, he makes observations on the effects of population growth and increased longevity, and on the small amounts spent for research.

In a book of this size the author could not cover the whole of his subject. We would like to know the facts and his opinion regarding such matters as the place of insurance and union fringe benefits in the economics of mental illness. If Blue Cross, private health insurance, group policies and union benefits covered mental illness to the extent that they do most physical illness, the cost would be the same, but burdens on government agencies and on the taxpayer would be much less, and the effect on the sufferer and his family less catastrophic. With less expenditures needed for the direct care of the mentally ill, more money would be available for research. In Europe, notably in Britain and in Switzerland, some mental patients are able to earn part of their way by industrial work

carried on in the state hospital premises. This may be possible in the United States, during times of full employment, with the co-operation of industry and unions. In these and other ways creative thought and experimentation can add further chapters to this important subject to whose study Dr. Fein's work has given such a useful impetus.

ROBERT A. CLARK, M.D.

Director of Resident Training
Friends Hospital
Philadelphia

JACOBUS TENBROEK and FLOYD W. MATSON. *Hope Deferred: Public Welfare and the Blind*. Pp. 272. Berkeley and Los Angeles: University of California Press, 1959. \$5.00.

While the authors have given a lucid review of legislation beneficial to blind persons and have emphasized what they consider the violation of the Social Security Act, as administratively interpreted by the Social Security Board, the book, as a whole, is marked by the strong prejudice of the authors in stating and defending their conception of the discriminated-against blind.

A book such as this must stand or fall on the validity of its basic premise. Can proof be established by listing thirteen or 130 current examples of shocking discrimination against blind persons on the part of the public when thousands of examples of the exact contrary could be produced? Can the attitudes of prominent authorities and spokesmen in the field of welfare of the blind be quoted in evidence that even such leaders do not accept the "normality, ability and adaptability of the blind population" when the quotations are from writings over a quarter of a century old or are lifted completely out of context and plainly at variance to everything else the quoted person has written?

It is regrettable that the authors throughout the book generalize about "the blind," who have little if anything in common except varying degrees of loss of vision. Nowhere are we reminded that according to the latest estimates obtainable from National Society for the Prevention of Blind-

ness 52 per cent of the blind persons in the United States are age 65 or over, about 85 per cent of these being 70 and over, and about 75 per cent being 75 and over. Are we to assume that these are all "normal, able, adaptable" and healthy and should be employed, even if they are not, in competitive occupations? How many had retired before they became blind?

The chapter on vocational rehabilitation is somewhat out of date—1954—and certainly gives no recognition of the very substantial achievements of many states, notably, New York State, where the Vocational Rehabilitation Service for the Blind (V.R.S.) contracts with private agencies for most of the psychological testing, counseling, vocational rehabilitation, and placements.

The so-called "sheltered workshops" are roundly condemned either as an agency for vocational rehabilitation for normal competitive employment or as a place of terminal employment for the severely handicapped deemed incapable of restoration to normal livelihood. Little evidence is offered to support such sweeping charges, even if true. The "oases" which brilliantly demonstrate what a modern factory for blind employees can do are not mentioned. One factory for blind workers paid in 1958, not including nine fringe benefits, annual wages ranging from \$2,180 to \$5,770, with 47 out of 165 blind employees earning over \$2,700. The authors state the average annual earnings of workers in National Institute of the Blind sheltered workshops in 1953 as \$1,100. In 1958 the average hourly wage was \$1.02.

On the whole, the creditable goal to improve public understanding of and opportunity for the blind has carried the authors too far from the actualities of present-day facts, thinking, or behavior. That we are far from the millennium, however, none would deny.

PHILIP S. PLATT

Madison, Connecticut

HARRY ECKSTEIN. *The English Health Service: Its Origins, Structure, and Achievements*. (Harvard Political Studies.) Pp. xxi, 289. Cambridge, Mass.: Harvard University Press under the di-

rection of the Department of Government, 1958. \$5.50.

This book by a professor of government at Harvard is a study of the development, structure, and achievements of the English Health Service. It deals mainly with the development and establishment of the Service, including a description of medical services prior to the war, the effect of the war upon them, the gradual growth of a view that after the war a substantial revision of the country's health services was needed; the development of plans of the Coalition government and of the Labor Party for the Service, and the role of the British Medical Association and the leaders of the profession. All of this takes three fifths of the book, leaving only 100 pages for a description of the Service and an appraisal of its operation and achievements.

Professor Eckstein finds that the coming of the Service was due to many factors. He is at pains to point out that the primary factor was not unmet medical needs of the lower classes; more important, in his view, was that the whole complex of existing arrangements had reached an impasse. They were not satisfying the upper, middle, or lower classes, nor the medical profession; the voluntary hospitals were bankrupt; the absurdity of the complete lack of co-ordination between the voluntary and public hospitals had become clear. The existing system was simply incapable of bringing the potentialities of modern medicine to meet the needs of the people.

The author bestows praise very stintingly in his appraisal of the accomplishments of the Service. "Some real progress has been made towards achieving its objectives." "It has improved many things and made nothing appreciably worse." Eckstein thinks it not too important that the Service makes available to all, free of charge or close to it, comprehensive medical care. To this reviewer that seems an important accomplishment, but Eckstein argues that, in general, medical care was available to all prior to the inception of the Service. He feels that the quantity and quality of the services now available are not much different than before. I think

some of these conclusions are arguable. The unexpected great demands for dental care and eyeglasses under the Service would seem to indicate that previous needs were not being met. Eckstein says that one of the accomplishments of the Service is a better distribution of physicians which would in itself indicate that areas formerly remote from medical care are now better served.

Eckstein holds that the cost of the Service has been quite moderate. The English expend a smaller percentage of the gross national product for maintenance of the Service than we expend for health services. Owing to other urgent demands upon the economy, there has been virtually no construction of new hospitals since the beginning of World War II. However there has been considerable refurbishing of old hospitals. He feels that it is time for the Service to go on a "spending spree."

It is obvious to Eckstein that the National Health Service has yet to be completed. The position of the general practitioner, isolated from hospitals and specialists, is unsatisfactory. There needs to be closer co-ordination or integration among the Regional Hospital Boards, the Boards of the teaching hospitals, the executive councils which administer the general practitioner service, and the local health authorities which administer the other health services.

On the whole this is an interesting and useful book on the English Health Service. It is a competent and unbiased study. It will be of special interest to those concerned with a rational, effective organization of our own health services.

LOUIS S. REED

Associate Professor of Medical
Economics
Sloan Institute of Hospital
Administration
Cornell University

HOWARD H. QUINT. *Profile in Black and White: A Frank Portrait of South Carolina*. Pp. vii, 214. Washington, D. C.: Public Affairs Press, 1959. \$4.50.

This is an interesting, accurate, and readable account of how South Carolina has

reacted to the 1954 decision of the Supreme Court regarding school desegregation. It is not pleasant reading. It reports the bitter editorials, the violent speeches of politicians, and the intense antipathies of white citizens in all walks of life. It relates the activities of numerous organizations which have arisen for the purpose of preserving white supremacy and of thwarting the Negro's efforts to improve his status—the Ku Klux Klan, the States Rights League, the National Association for the Advancement of White People, the Grass Roots League, the Federation of Constitutional Government, and the White Citizens Councils.

While the book is focused on South Carolina, it is in effect a study of the Deep South, for the same sentiments, organizations, and activities recounted here are characteristic of other southern states. It reveals the lengths to which whites are prepared to go in their determination to maintain their caste system.

The principal sources used were five South Carolina newspapers. The *Charleston News and Courier* reflects the sentiments of the most extreme segregationists. The *Florence Morning News* was, until its editor was forced to resign, an advocate of "militant moderation." The *Columbia State* and the *Columbia Record*, while conservative, are less extreme than the *News and Courier*. Finally, the *Anderson Independent*, though no supporter of integration, is loyal to the national Democratic party and devotes less attention to the race issue. These sources were well chosen, for they represent a cross section of the state's press, both geographically and ideologically.

The author is a native of Connecticut and for eleven years was on the faculty of the University of South Carolina. Because he believed that this book should be published, but did not wish to cause embarrassment to the University, he resigned his position prior to publication.

The book arrives at three main conclusions: (1) South Carolina has not yet embraced democracy "as the term is generally defined by Americans outside the South." (2) Many South Carolinians accept a racism which "approaches that of Hitler

and the Nazis." (3) Not a few of the arguments of the segregationists are illogical and riddled with inconsistencies.

The author is very careful with his facts, and what he has to say is well documented. However, his own position is not an impartial one, and he makes no pretense at writing an "objective" history. He frankly states that he regards the abolition of racial segregation as desirable, that Southerners are fighting "the tide of history," and that the Negro's efforts to end segregation will be successful. However commendable and true these convictions may be, the author's commitment to them is such that his book partakes more of a polemic than of "a frank portrait of South Carolina." This reviewer is also of the opinion that the author overestimates the North's enthusiasm for democracy and integration. Since he, however, like the author of this book, is also committed to these values, he rejoices that this book has been written, and hopes that it will reach a large audience.

BREWTON BERRY

Professor of Sociology and
Anthropology
Ohio State University

H. HARRY GILES. *The Integrated Classroom*. Pp. xii, 338. New York: Basic Books, 1959 \$5.00.

Teachers and school administrators faced with problems of integrating minority and majority group children into their schools should find this book very useful. The book has three parts: 1. A description of the conflict between majority and minorities as it exists in the schools today, particularly in view of the Supreme Court 1954 decision declaring forced segregation illegal. 2. An analysis of the sources of the conflict in American ideals, in hereditary and socially learned differences and in attitudes. 3. A list of procedures and teaching aids suggested as tools for reducing the problem.

The first part of the book is valuable especially for its comparison between school systems that have integrated successfully and those that have resisted integration. Points of view recorded are those of the Supreme Court, the resisters, the minority group leadership, and the child-

ren involved in integration. In addition to using popular and scholarly sources of information, the author has gathered statements from children regarding their own experiences and attitudes and what their parents have told them, and from teachers and school administrators regarding their problems and experiences with integration.

The analysis of the problem in the second part of the book is so superficial as to be misleading if the teacher were to rely primarily on it. The author would have done better merely to outline the sources for an analysis rather than to attempt to provide the analysis itself in so brief a space. In some eighty pages, the author attempts to provide a history of American minority problems, an analysis of American ideology, the anthropology of race and the social psychology of racism, a statement of Negro goals, the research on the consequences of prejudice and discrimination, the sociology of group relations, psychiatric and other explanations of prejudice—and then he attempts to relate all this to the problem of integrating children in a classroom. Such a hodgepodge will confuse most of his readers even though it contains no specific errors.

If the author is weak on theory, he is strong on practical suggestions. The teaching aids offered range from a general plan for integration to the most specific suggestions for conducting the first day's classes, and from visual aids to techniques for handling grievances. Books, films, recordings, organizations, and other means of getting assistance in the practical problems of integrating a classroom are listed in handy form. This section alone justifies the volume.

ARNOLD M. ROSE

Professor of Sociology
University of Minnesota

HAROLD W. STOKE. *The American College President*. Pp. ix, 180. New York: Harper & Brothers, 1959. \$3.50.

There are now some 1,800 college and university presidents in the United States. Obviously this number is large enough to constitute a subspecies of *homo academicus*, and this reason alone would justify the recent upsurge of interest in the char-

acter and problems of the American college president. Dr. Stoke adds a further justification for his book. It is his thesis that the recent changes in responsibilities of the colleges and universities in this country have forced the president of the college into a new and unique position. Once upon a time he was a scholar or a clergyman, and his administrative tasks took up very little of his time. His primary concern was education, and all the other tasks of his office were secondary to that.

Today the job has become vastly more complex, and Dr. Stoke undertakes to analyze the nature of the job in terms of its various relationships to the faculty, to the students, to the trustees, to the public, and so on.

Dr. Stoke obviously speaks with authority. A former president of the University of New Hampshire and of Louisiana State University, he is now president of Queens College in New York City. He has also served as dean of the Graduate School of the University of Washington and as dean of the Graduate School of Arts and Sciences in New York University. Out of this wealth of experience, and out of wide reading and discussion with other college presidents, he has distilled this analysis of what a modern college president has to do, and what the perils as well as the delights of his job are.

As a new university president, I must say that I think this book should be given to presidents only after they have been inaugurated. For although Dr. Stoke stresses frequently the rewards and satisfactions which a college president gets, actually the great bulk of the book is devoted to the trials and tribulations. College presidents can only pray that this book will have a wide circulation outside of academic circles, in the hope that the general public will understand a bit more clearly the difficulties which constantly confront a college president, and will also come to know why he behaves as he does from time to time.

This book will perhaps also serve to explain to faculties and to students the peculiar position that their president finds himself in. Dr. Stoke shows very clearly the kind of qualities that a faculty would

like to find in the president of their institution, but he also shows why this combination is often almost impossibly difficult.

What Dr. Stoke fails to show in this book is why anyone would ever want to be a college president. The general assumption seems to be that one finds himself in the position, and then looks around him and finds all these besetting difficulties. But surely there must be many college presidents who find themselves in their job not merely because of their desire for status, but rather because of some idealism, possibly doomed to frustration, which makes them feel that in their position they can accomplish some greater good than would be possible in some other position. Such idealism, however, must properly be educational in character, and if, as Dr. Stoke suggests, the president has less and less to do with educational matters per se, then the frustration must be inevitable and occupational.

I may be wrong in detecting an overtone of almost despair in President Stoke's analysis of the subspecies. But if I do detect it, then something is very wrong indeed with the college presidency. The American college is essentially a healthy and vigorous institution, but if its tone is to be set by a president who is constantly plagued by frustrations, then this health and vigor cannot be guaranteed for the future. Dr. Stoke may have well provided an enormous service to American university life by pointing out this danger.

Or possibly it is just that college presidents talk too much to each other.

MASON W. GROSS

President

Rutgers, The State University

KARL JASPERS. *The Idea of the University*. Edited by Karl W. Deutsch, translated by H. A. T. Reiche and H. F. Vanderschmidt. (Seeds-of-Thought Series.) Pp. xxi, 135. Boston: Beacon Press, 1959. \$3.75.

This little volume probes deeply into the subject of the higher learning and into the meaning of the university ideal. After dealing with the methods and assumptions of science and the nature of philosophy, the author declared that they do not coin-

cide, that philology is not just another science for it differs from science in origin, method, and meaning. While it pervades science and guides it, it is not accessible to its method.

The author touches but lightly on the meaning of culture, defining it as an acquired state, and citing, as examples, the Greek, Roman, and English ideals. The educational values of the liberal arts and the natural sciences, he suggested, are so different as to appear to represent two distinct cultural ideals. Humanism and realism have not yet been joined together for their mutual enlightenment.

With this introduction, the author proceeds to discuss the objectives of the university and the requisites for its existence.

The university has three functions—"research, transmission of learning, and education to culture." All three are essential; if isolated, the spirit of the university is lost. Teaching is stimulating to research, and, at the same time, vitally needs what research alone can supply. The university cannot achieve these purposes except in the framework of an institution which, in itself, is a standing threat to "the idea of the university."

Political and sociological influences affect the forms of the university but despite the changing forms its integrity is maintained by the timeless ideal of intellectual insight which is dominant though always in danger of being lost. A university's corporate independence and autonomy are assured by its charter and yet it is responsible to the state that charters it. Consequently, the great question is whether society will agree to reserve a place for an understanding which may be beyond its comprehension.

The author's experience in Hitler's Germany makes him keenly conscious of the forces that can destroy the university. He warns that it can serve nations or mankind only "through the medium of intellectual creativity" and that "it suffers when it seeks to serve extraneous purposes." He concluded that "nationalism, like everything else, forms a legitimate topic of research but cannot provide the basic direction of the university itself."

Though the presentation of *The Idea of the University* is somewhat disjointed and

its meaning brought out indirectly, reading it heightens one's sense of the crucial importance of the ideal "the lifeblood of higher education," as he termed it, and of the dangers which beset its path. It is an eminently timely and worthwhile contribution to educational thinking. It has a special message for the English-speaking world where, since World War II, the universities have, for the first time in history, become predominantly publicly-supported institutions.

OLIVER C. CARMICHAEL

Consultant to the Fund for the
Advancement of Education
New York City

JOHN A. PERKINS. *Plain Talk from a Campus*. Pp. vii, 195. Newark, Del.: University of Delaware Press, 1959. Distributed by University Publishers, New York. \$4.00.

Written by a man of stature, balance, and broad experience in the field of education, this book ranges freely and, for the most part, with a gentle tread through the fields and groves of Academe. Dr. Perkins, President of the University of Delaware for the past nine years, seems to be at his most authoritative in speaking of the financial problems and plight of higher education. While recognizing the increasing but still inadequate contribution of corporate industry, he applauds the steps taken by the federal government and urges much more extensive and intensive aid from both state and national treasuries.

On the theme of class versus mass, or education for the élite versus education for all, Dr. Perkins takes a moderate view. He feels that colleges and universities must supply both education for leadership and education for citizenship; they must help our best young minds fulfil their potentialities, and at the same time they must not underestimate or exclude the average.

Another recurring theme evolves from Dr. Perkins' understandable interest in public universities and colleges. He points out on several occasions that public colleges in recent years—since 1953—have enrolled considerably more than half of the total number of students, until in 1958, when 61.3 per cent of all freshmen en-

rolled in public universities and colleges. The status, the inadequacies, and the hard times ahead for public higher education are competently and authoritatively dealt with.

Finally, Dr. Perkins calls repeatedly throughout the book for single-minded devotion on the part of faculty and students alike to the true goal of education "Every student who enters a university should have complete commitment and involvement in one great cause—learning" (p. 195). One gets the impression that Dr. Perkins would make short shrift, if he had his way, of such extra-academic activities as football, fraternities, and most of the usual social activities.

This book deserves a wide readership among college and university teachers and administrators; its appeal to the lay public, I am afraid, would be somewhat limited. At best it is wise and gentle, at worst somewhat superficial. It touches on most of the important aspects of higher education today and tomorrow, emphasizing the adjustments that ought to be and have to be made to meet the challenge of tomorrow's tidal wave and yesterday's Sputnik. This is indeed plain and interesting talk from a campus. With a refreshing lack of pompousness, Dr. Perkins sounds somewhat less like a university president than like an educator on his day off.

RANDALL W. HOFFMAN

Dean of Students
Hofstra College

ECONOMICS

THOMAS C. COCHRAN. *The Puerto Rican Businessman: A Study in Cultural Change*. Pp. 198. Philadelphia: University of Pennsylvania Press, 1959. \$5.00.

Professor Cochran has utilized a great deal of valuable information, astute analysis, and meaningful hypotheses in his small book. Following a concise account of "aspects of economic and business growth" from 1898 to 1955, the author confronts his central problem, namely, the effect of

Puerto Rican culture on business enterprise.

Over one hundred Puerto Rican and mainland businessmen were interviewed, representing older leaders, younger entrepreneurs, and a comparative group of United States manufacturers. The questionnaires used appear in an Appendix.

The study revealed how certain Puerto Rican social and cultural features, stemming in part from the Spanish heritage, have impeded economic and business growth as viewed from the mainland standpoint. In particular, Professor Cochran explored such socio-cultural characteristics as the family-centered pattern, the role of *personalismo* in business enterprise, the special Latin American or Spanish type of individualism, and its linkage with the subtle concept of *dignidad*. He found, for example, that the family-centered pattern associated with a stable agricultural society has been carried over into business enterprise only slightly transformed as the family firm.

Personalismo, which demands face-to-face contacts between buyer and seller, employer and employee, and so forth, persists in Puerto Rico despite being wholly unsuitable to modern enterprise. *Dignidad* and the special individualism which stress man's uniqueness as an individual in terms of personal inner qualities place extra burdens on the entrepreneur in many crucial ways. These are spelled out in the book.

Professor Cochran sums up his findings as follows: "The Puerto Rican social and cultural heritage has often sacrificed progress for family interests, fostered nepotism, hindered the building up of a supply of professional managers, increased the difficulties of supervising production, reduced interest in new and more efficient technology, lessened the urge for expansion, and made entrepreneurs unwilling to merge in order to gain larger volume and secure essential technical advice" (p. 163).

The fact that the patterns found in Puerto Rico apply widely throughout Latin America as well lends added significance to the author's findings.

The ways and means by which Puerto Rican business practices are being influenced by United States entrepreneurship

are also described in detail. Nevertheless, the author maintains judicious restraint in all questions of comparative values between mainland and island patterns. Although he indicates trends toward change throughout the book, Professor Cochran sensibly limits himself to most cautious predictions on the future of Puerto Rican economic and business enterprise. This is an excellent book, one to be recommended without reservations.

MORRIS SIEGEL

Visiting Professor of Anthropology
University of Illinois

JOSEPH DORFMAN. *The Economic Mind in American Civilization*, Vols. IV & V: 1918-1933. Pp. lxxxviii, 776. New York: Viking Press, 1959. \$12.50.

This two-volume work concludes a monumental task begun some twenty years ago which has no equal in the whole of economic literature. The first three volumes treat the period from 1606 to 1918. The last two volumes cover the exciting years when changes in the economy were exceeded only by greater changes in economic thinking and in remaking national policy. The years since 1933 Professor Dorfman leaves to future writers.

The pages of these volumes reveal even more strikingly than the earlier ones the economic mind at work in shaping the course of events. The reader will find the familiar names of the best-known economists, politicians, and statesmen and the parts they played, both directly and indirectly, in helping to build both past and present doctrines and policy. The work of less well-known persons, academic or otherwise, social and economic reformers, popular movements, pressure groups—in fact, nearly everyone who had a part in the events of these historic years—claims our attention. A great deal more than a mere history of the economic aspects of the period is presented. The student from any discipline or the average reader will find in these two volumes a comprehensive treatment of the socio-economic events of the fifteen eventful years from 1918 to the New Deal in 1933.

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years and the criticism they evoked. New schools of thought and their exponents, new developments in specialized fields such as labor, monetary theory, foreign trade, agricultural economics, crisis and business cycle theory, depression measures, and many other items get careful treatment.

Care has been taken to avoid repetition of biographic materials presented in the earlier volumes. Frequent reference is therefore made to facts in volume three when needed to supplement the current discussion. The new materials serve to etch the persons firmly in the 1918-1933 setting. The controversial issues and personalities are treated with unusual fairness and objectivity.

The two volumes are divided into two parts; the first part (20 chapters), the Era of Adjustment and Progress, covers the story of the 1920's after the Armistice. Part two (5 chapters) deals with the depression years 1929-1933. The events and the persons who shared in them are vividly described. The reader who remembers the eventful years will relive them; the younger generation of readers will find an excellent account of the travails which beset the economy and of the measures designed either to reverse the trends or to bring semblance of stability. These five chapters contain the best description of the depression known to this reviewer.

The coverage of materials in these volumes is broader than that found in the preceding ones for they contain far more than the basic ideas associated with a history of economic thought. The part played by economists, business men, labor leaders, politicians, pressure groups, the growth of 'isms, the panaceas for social, economic, and political reforms are presented. The thoroughness of the researches and the detail of accurate presentation are results of patient and scholarly research.

The present volumes together with the three earlier ones provide an encyclopedia of American economic materials without peer. They offer far more than the workings of the purely economic aspects of the nation in the given years, but rather a panorama of its culture and growth. Both the successes and the failures of the measures receive attention. There is ample

proof that the economy has basic staying powers and that great progress, although costly at times, can be made without major revolutions.

J. F. BELL

Professor of Economics
University of Illinois

CLARENCE SENIOR. *Land Reform and Democracy*. Pp. xiii, 269. Gainesville: University of Florida Press, 1958. \$6.75.

This is a case study of land reform in its relation to democratic achievement. Since it is the author's objective "to lay the basis for an understanding of the principal problems of agrarianism, in so far as its advocates hope to build a new social system in which democratic values and practices are basic," he points up his argument by reference to the agrarian experiment with which he is most familiar—La Laguna in Mexico.

La Laguna is located in a dry lake area of north-central Mexico where the states of Coahuila and Durango adjoin. Although inhabited by seminomadic Indians when the Spaniards first discovered the region in the sixteenth century, Laguna did not achieve its potential until late in the nineteenth century with the coming of European capital and technology which brought water and prosperity to the region. Cotton and wheat were grown on irrigated land which required exploitation on a fairly large scale and with expensive machinery to bring economic success. These holdings were expropriated by decree of President Cárdenas on October 6, 1936, and given to *ejidos* or farm groups in which the land was commonly owned and co-operatively worked.

To say that Dr. Senior is familiar with La Laguna is an understatement, for he is undoubtedly the outstanding authority on the project viewed from the socio-economic angle. According to his own confession, from March 1937—six months after the expropriation—to August 1952, he made periodic visits to the region on twenty-three different occasions. The visits extended from three weeks to six months. For several summers he conducted, under the auspices of the American Friends Service Committee, groups of college students

from the United States who helped the peasants build schools, dig irrigation ditches, erect cotton gins, and so forth.

Dr. Senior's intimate acquaintance with, and comprehensive understanding of the various aspects of the La Laguna experiment are most impressive, and indeed can be accepted in most respects as authoritative. Therefore, if his excellent exposition is liable to criticism it is purely on the basis of omission.

This political scientist is not satisfied with the picture of the La Laguna community, because there is little or no discussion of political action. The region and its inhabitants are fully and ably described from many angles, but not the political. Since the objective of the study is to indicate progress made along the democratic highway, it is surprising that no account was taken of La Laguna representation in the agrarian sector of the Party of the Institutional Revolution (PRI), nor of the elector process in local, state, and national campaigns. It is still valid to measure democratic achievement by a political yardstick.

Despite his enthusiasm for the La Laguna project Dr. Senior is critical and restrained in his final judgment. He says, "the building of democracy must extend far beyond the agrarian institutions directly involved and be expressed in structure and functions of all major social institutions if a fundamentally sound democracy is the aim." The shortcomings of La Laguna should warn against future error in agrarian reform.

J. LLOYD MECHAM

Professor of Government
University of Texas

WALTER GALENSON (Ed.). *Labor and Economic Development*. Pp. xiii, 304. New York: John Wiley & Sons, 1959. \$6.75.

The Inter-University Study of Labor Problems in Economic Development has sponsored an impressive collection of research essays on the labor factor in the economic development of five greatly different societies in widely separated parts of the world and in very different stages of industrialization: India, by Charles A. Myers; Japan, by Robert A. Scalapino;

Egypt, by Frederick H. Harbison; French West Africa, by Elliot Berg; and the British West Indies by William H. Knowles. Since all five studies necessarily emphasize the particular problems of an individual country or area, the incisive Introduction by the editor Walter Galenson, rightly concentrates on problems and characteristics common to all five, or at least to some of them.

The editor's introductory summary benefits from the common outline followed by the individual studies. All of them cover, in approximately the same order, (1) the particular cultural, economic, and to a somewhat lesser extent historical and political background of their country or area; (2) the processes and problems accompanying the growth of a labor force committed to industrial employment; (3) the development and characteristics of labor organizations, including their history, structure, and government, leadership, politics, and ideology; (4) the nature and problems of industrial management; and (5) the role of government as the leading force in the economic development process and as the dominant partner in the triangular labor-management-government relationship.

This common framework is yet flexible enough to permit considerable variation in approach and emphasis as necessitated, on the one hand, by the different backgrounds and interests of the contributors and, on the other, by the objective differences in their material. We are dealing after all with one country, Japan, which was never a colony of a European state, one area, French West Africa, which except for the recent change in Guinea is still an overseas territory of France, and three others that attained their independence or self-government from Britain in very recent times. We are also confronted with the already highly industrialized nation of Japan and four others in various early stages of industrialization and with quite different growth potentials. The cultural and historical differences are, if anything, even greater than the economic and political ones.

These real differences need not obscure the less easily perceived similarities so ably summarized in Professor Galenson's intro-

ductory chapter. To this summary, which for lack of space cannot even be sketched here, I would add only the observation that all five studies appeared to contain the underlying expectation that under more fortunate circumstances the several trade union movements would, and should, act more like American labor organizations—and that labor-management relations would someday hopefully acquire the proven patterns found in the United States. This is a shortcoming against which comparative research must constantly be on guard.

All five essays are summaries of monographs which have either appeared in book form already (Myers, Harbison) or else are being prepared for separate publication (Scalapino, Berg, Knowles). The present volume will appeal to a wide circle of readers interested in the social and economic aspects of economic development. It is also well fitted for classroom use. The area specialist or the student of economic development will, however, want to consult the monographs on which these studies are based.

JOHN P. WINDMULLER

Associate Professor of Industrial
and Labor Relations
Cornell University

HYMAN G. WEINTRAUB. *Andrew Furuseth: Emancipator of the Seamen*. (Publication of the Institute of Industrial Relations, University of California.) Pp. x, 267. Berkeley and Los Angeles: University of California Press, 1959. \$5.00.

This book may be considered under three principal headings. In the first place, it is an excellent job in writing, in organization of the material, in documentation, and in printing. It deals with an interesting period, 1880 to 1936, in the life of the American sailor. It opens with Andrew Furuseth and his fellow sailors working on the sailing ships—they were craftsmen of a sort, but it is in the latter days of the craft—and the troubles of the sailors, afloat and ashore, mount as the economic relationships of owners and seamen become almost completely depersonalized; it closes in the last days of Furuseth after he, with his associates, had brought the plight of

the sailors to the attention of government, and laws had been passed that gave the seamen a measure of protection from the economic conditions that burdened their lives.

In the second place, Dr. Weintraub brings into his study a considerable degree of admiration for Andrew Furuseth, the man. This is a result of delving deeply into Furuseth's character—his philosophy, his astuteness, his courage, his living habits, and his foibles. It is difficult, I think, for the reader to work up any great affection for Furuseth, however much one may admire his single-minded devotion to the seamen and to the Sailors' Union of the Pacific. Throughout his long life, Furuseth thought of the sailor as a craftsman; a man who had served his apprenticeship; one who had advanced to become an "able seaman." In itself, this was a most useful bit of ancient history for Furuseth. It helped to create unity among the seamen; it served to limit their numbers in the labor market; and it impressed some legislators with the justice of the bills that Furuseth was lobbying for in Washington. Nevertheless, this admixture of mythology brought forth some attitudes and actions by Furuseth that were far from admirable. He created difficulties for all workers by fighting the longshoremen; his overt dislike of some nationalities caused discord among union members; and his stubbornness in insisting upon his own wording in proposed laws and in administrative orders finally alienated his friends. But when we set side by side the contributions and the failures of the man, we must agree that the former far outweigh the latter. It is this weighting of the scales that Dr. Weintraub has most successfully accomplished, and we must agree with him that Furuseth well deserves the title "Emancipator of the Seamen."

In the third place, this is a book of considerable breadth. It covers Furuseth's activities in the Sailors' Union of the Pacific, in the International Seaman's Union, in his many visits to Europe and to Washington, D. C. It deals in detail with the enactment of the various laws for the protection of the seamen, and with the political manipulations that went on behind the

scenes; it describes the struggles with the shipowners on the Pacific Coast and in the national capital. Dr. Weintraub is to be congratulated upon bringing back to life an all but forgotten, important labor leader.

FREDERICK L. RYAN

Director of the Institute of
Labor Economics
San Diego State University

MELVILLE DALTON. *Men Who Manage: Fusion of Feeling and Theory in Administration*. Pp. xi, 318. New York: John Wiley & Sons, 1959. \$6.75.

The author is Associate Professor of Sociology at the University of California, Los Angeles. The book deals with the methods, procedures, and compromises by which managers attempt to reconcile rational industrial organization with pragmatic, intuitive and largely irrational human ends. The original field work covers four anonymous concerns in the Middle West; this material is supplemented by an extensive review of relevant literature.

The case material indicates that managers are engaged in a continuous struggle for power; that they govern by the creation and manipulation of cliques and factions; that their methods are frequently reprehensible by accepted standards of morality; that they condone violation of established rules, evasion of responsibility, sabotage of production, and secret manipulations of working rules and grievance procedures. An atmosphere of tension and distrust pervades the organization; the roadside is strewn with human wreckage—the frustrated, defeated, neurotic victims of the system. Nevertheless, top management, by a complex process of manipulation and compromise, contains these interpersonal conflicts within tolerable limits, adjusts organizational necessities to human ends, and gets the job done.

The nature of this job, however, is not clear. Is it to maximize profits, to produce goods at minimum cost, to serve the public welfare, to develop human personality, or merely to advance the personal interests of management? By failing to posit a defensible goal, external to the organization itself, the author denies himself any valid standard of social criticism.

Lacking this, he accepts a sort of naturalistic, Machiavellian theory of industrial politics, from which all moral and social values are excluded, and in which even the ignoble ends and base conduct of management are endowed with a certain pragmatic sanction. He ends on a weak note of facile optimism: "Contained conflict in industry gets the job done, brings recognition to those who blend the official and unofficial, and speeds personal growth to bear responsibilities" (p. 264).

The factual report of observed practices constitutes a devastating critique of industrial management. There is, however, an unintentional bias here arising from overemphasis of the sordid, and relative neglect of the good manifestations of human behavior. Little attention is given to the influence of those basic virtues, such as honesty, integrity, courage, loyalty, and toleration, without which social co-operation would be impossible. In the strengthening and more effective application of these social virtues lies the hope for the future. Instead of merely condemning the aberrations of industrial management, or excusing them on grounds of naturalism or organizational necessity, we should strive to make management more moral, more humane, and more socially responsible.

HORACE M. GRAY

Professor of Economics
University of Illinois

SEYMOUR MELMAN. *Decision-Making and Productivity*. Pp. xii, 260. New York: John Wiley & Sons, 1958. \$7.00.

This is a most interesting book, and its frame of reference is a welcome addition to the growing literature of decision-making in industry, particularly, the automobile industry. While the author refers to his subject as "the politics of production," this reviewer would like to add it is more appropriately the "human relations" of production.

Dr. Melman definitely shows that a single "best way" in decision-making is an outmoded characteristic of behavior. Major alternatives do exist and have a most discernible effect on productivity.

The author has used as his base of study the Standard Motor Company of England;

the data he employs are mostly representative of the period 1950-53. Incidentally, it should be emphasized that a study of this kind would not be possible unless both management and labor co-operated. In this instance, the author had every reason for being most grateful to the Standard family.

In presenting his analysis of alternative modes of decision-making the author has been careful in his understanding of deterministic-causal processes and their common ignoring of deliberate control. Therefore, this book is offered as an exploratory approach in terms of defining opportunities which exist for accelerated productivity.

One final comment should be made. Though the subject matter uses an English firm for its major concern, the thesis and conclusions are certainly applicable in terms of serious, suggestive possibilities to other firms regardless of national locale. The material included will be a point of vital discussion for a long time to come.

ARTHUR LERNER

Psychology Department
Los Angeles City College

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